S. HRG. 98–19

S. 499, A BILL TO REQUIRE THE USAGE OF TAX-EXEMPT FINANCING IN CONNECTION WITH THE SMALL BUSINESS ADMINISTRATION'S SECTION 503 LOAN PROGRAM

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 499, A BILL TO REQUIRE THE USAGE OF TAX-EXEMPT FINANCING IN CONNECTION WITH THE SMALL BUSINESS ADMINISTRATION'S SECTION 503 LOAN PROGRAM

FEBRUARY 17, 1983

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S. 499, A BILL TO REQUIRE THE USAGE OF TAX-EXEMPT FINANCING IN CONNECTION WITH THE SMALL BUSINESS ADMINISTRATION'S SECTION 503 LOAN PROGRAM

THURSDAY, FEBRUARY 17, 1983

U.S. SENATE,
SMALL BUSINESS COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 2:10 p.m., room 424, Russell Senate Office Building, Hon. Alfonse M. D'Amato (acting chairman of the committee), presiding.

Present: Senators D'Amato, Huddleston, Levin, and Tsongas.

Also present: Alan L. Chvotkin, chief counsel, minority; Robert M. Wilson, counsel; and Bruce A. Ray, legislative assistant to Senator D'Amato.

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator D'AMATO. Today the Small Business Committee is conducting a hearing on S. 499, a bill to require the usage of tax-exempt financing in connection with the Small Business Administration's section 503 loan program. We will now convene for testimony.

Today we will hear from Edwin T. Holloway, the Associate Administrator for the Office of Finance and Investment of the Small Business Administration; Mr. Steve Gurian, president of the Long Island Certified Development Corp.; and Mr. Scott Berman of the Lawrence Avenue Development Corp., Chicago, Ill.

I would like, before we call Mr. Holloway up, to make some observations: On September 28, 1982, this committee held an oversight hearing which I chaired on the Small Business Administration's section 503 loan program. The testimony at that hearing was unanimous. The 503 loan program is a good program; in fact it is a potentially excellent program. However, in the first 2 years of its existence it has been plagued by a number of minor problems and one major, glaring deficit—the refusal of the SBA to participate in any 503 loan where other parts of the financing package include, or are collateralized by, tax-exempt industrial revenue bonds.

It is this defect that I intend to focus on at today's hearing. I have introduced legislation, S. 499, which is specifically designed to prohibit the SBA from discriminating against industrial development bonds when making decisions on applications for funding

under the 503 loan program. It is my hope that the witnesses today will focus on this bill.

If they are optimistic, as I am, about the merits of the legislation, as optimistic as I am about the large number of new jobs which will result from its passage and implementation, then I will move quickly and forcefully for its passage. I will seek an expeditious markup of the bill by this committee and will move as swiftly as possible toward its passage. Given the state of our economy, I don't think that we should delay enactment of a jobs bill such as S. 499.

Section 503 of the Small Business Investment Company Act was designed to make the SBA an active partner with State and local governments and the private sector in making long-term capital available for small business expansion and creation. The 503 loan program enacted in July 1980 can play an important role in revitalizing local communities across the Nation. Under section 503, banks are encouraged to make long-term loans available to small businesses under favorable terms. Without Federal guarantee programs such as 503, banks are often reluctant to make such loans to small companies.

Section 503 authorizes the SBA to guarantee debentures issued by certified development companies to finance the acquisition of land, plant, and equipment for small business expansion. The creation of a substantial number of new jobs is a requirement before any such loan can be made. SBA guarantees up to 40 percent of the project costs. Ten percent comes from the small business itself, and the remaining 50 percent comes from a private sector, third-party lender, such as a bank. Maturities on these loans can be for up to 25 years.

SBA began certifying CDC's in late 1980. As of January 31, 1983, 352 have been so certified. Ten of these are in my own State of New York. Another 32 applications are pending nationwide. A majority of these development companies are just getting off the ground, but 150 of them had made a loan by the end of 1982 and 90 of them had made more than one loan. All told, 833 loans have been made, nearly 40 of them in New York State.

The 40 percent of the project costs put up by the CDC's for these 833 loans totaled $150.3 million. By October 1, 1982, 28,846 documented jobs had been created as a result of the 503 loans, with an average SBA investment per job of only $3,990. The current SBA estimate of the number of jobs created approaches 40,000, and the average investment per job has been steadily dropping since the inception of the 503 program. The vast majority of the jobs created are in the manufacturing and wholesale/retail industries.

In New York State, $6.08 million in loans had been guaranteed by the SBA by the end of fiscal 1982; 1,422 jobs had been created. The average SBA investment per job was $4,668, but this figure is being brought down rapidly. The 1,115 jobs created in fiscal 1982 required an average SBA guarantee of only $3,223 per job; the 305 jobs created during the last quarter of fiscal 1982 required an average investment of only $3,045. Every quarter since the creation of the 503 program, more and more jobs are being created as the Federal commitment per job declines. Section 503 is a classic example of a Federal jobs program that works, and works well.

However, as I said at the beginning of my remarks, all is not perfect with the 503 program. The program is new. Many, both inside and outside of the Government, are unfamiliar with it. The regulations governing the program still need fine tuning, and the turnaround time on loan applications is still too slow, although I should mention that I am informed that the turnaround time has been significantly reduced since this committee first focused on this problem at the September 28 hearing. I have been assured further that the SBA is making a concerted effort to work out other bureaucratic entanglements as well. I am confident that things will soon be running much more smoothly.

One great problem with the program, however, is still in desperate need of legislative action. This is the fact that SBA, in complete and total contradiction of clearly expressed congressional intent, has refused to guarantee or participate in 503 loans for projects in which industrial development bond financing is used. This action has been taken as a part of the administration's overall policy of discouraging the use of small-issue industrial development bonds.

Since coming to the Senate, I have been a vocal supporter of IDB's. Although I had not yet begun my service when the conference report on Public Law 96-302 was adopted, I totally agree with what it said about the 503 loan program:

> SBA should not disapprove the guarantee of any debenture, or any loan made with the proceeds of a debenture issue, solely because the proceeds would be used in a project whose other sources of financing include, or are collateralized by, tax-exempt industrial revenue or development bonds.

This seems pretty clear to me, yet the SBA has refused to participate in any such project. A 1965 OMB circular, A-70, which states that it is not the Government's policy to provide a guarantee of a tax-exempt issue, has been cited as the reason for this intransigence. Never mind that under the section 503 loan program, the Government guarantees only the CDC portion of the project cost and provides no guarantee, direct or indirect, to any portion financed or collateralized by an IDB. In spite of the fact that a 1980 expression of congressional intent should clearly supersede an outdated bureaucratic memorandum, and in spite of the fact that our economy desperately needs the new jobs that would result from more 503 projects, the SBA still refuses to participate in such loans and, as a result, over 60 percent of the loan guarantee authority provided by the Congress for the 503 program has gone unused.

At the September 28 hearing, SBA's policy on this matter was universally condemned by all of the private sector witnesses. The point was made repeatedly that we are running a good program—a potentially excellent program—at less than half speed because the SBA has refused, thus far, to honor clearly expressed congressional intent. Loans which should be made are not being made, loan authority is going unused, and, most importantly, new jobs which could be created are not being created.

The legislation which we are considering today, therefore, comes in direct response to this widely perceived need for congressional action. The bill itself is simple. It merely requires that the SBA process section 503 loan applications without regard to whether or not parts of the financing package include or are collateralized by

industrial development bonds. This bill simply raises existing conference report language to the status of legislation.

No other solution has worked. Despite my concerted efforts and the efforts of this committee as a whole, negotiations over the issue have really never taken place. They have broken down. Thus, the Congress must act. The 503 loan program must be allowed to achieve its full potential. The majority of the loan authority created by Congress for this program must not continue to go unused. The authorized loan authority for the 503 program is $250 million annually. That is what we should be using, not the $99.6 million that was used in fiscal 1982.

There is a great demand for this program in the small business community across the Nation which has been artificially squelched by the SBA policy on IDB involvement. I believe we must eliminate that policy. We must increase the number of 503 loans made. We need the vast number of new jobs that will result.

Today we will receive testimony from Edwin Holloway, Associate Administrator of the SBA, who was also with us at the September 28 hearing. In addition, we have two other repeaters: My good friend Steve Gurian, president of the Long Island Certified Development Corp., which is one of the most active CDC's in the country; and Scott Berman, president of the Lawrence Avenue Development Corp., in Chicago. Also testifying will be Robert Bowman, the commissioner for economic development of Louisville, Ky., and William Kelley, president of the Hancock Bank & Trust Co. of Quincy, Mass. I welcome these witnesses here and I look forward eagerly to their testimony.

Before I ask my good friend and colleague, Senator Tsongas, if he has any remarks to make, and before we call our first witness, let me just simply say once again, I find it rather intolerable that the legislative will of the Congress is completely thwarted by OMB, repeatedly, and for no good reason, for no savings whatsoever. The fact of the matter is that if these moneys were able to have been used effectively, if the money for this program were put to use, we would have put thousands of more people to work in meaningful private sector jobs. They would have been paying State taxes, local taxes, county taxes, and Federal income and social security taxes. This would have improved the economic climate appreciably.

Instead we get this bureaucratic mumbo-jumbo. We have an OMB Director who thinks he is the czar of the country. In fact, just willy-nilly in many cases, he puts forth programs based upon a dogmatic philosophy that has little relationship to the truth.

This program does not cost taxpayers money. In the long run it is a wise investment that earns taxpayers money, and I'll be doggoned if I came down here to have that kind of program stymied for no good reason. If it is a battle they need, it is a battle they are going to get. I am convinced that we are on the right track and should not be stifled by meaningless, insensitive bureaucratic regulations again that thwart the legitimate will of this Congress.

Before I call on Senator Tsongas for his remarks, I shall insert several statements from Members of the committee at this point in the record.

[Material follows:]

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, SENATE SMALL BUSINESS COMMITTEE

Today the committee will hear testimony on S. 499, introduced by Senator D'Amato, to require the Small Business Administration to permit the use of tax-exempt financing in conjunction with the SBA's section 503 program. I commend by colleague, Senator D'Amato, for introducing this timely legislation.

As unemployment continues at unbearably high levels, we in the Government will have to seek solutions to relieve the misery of our Nation's jobless citizens. While many jobs programs will be proposed in the next few weeks, I strongly believe that those proposals should focus on providing meaningful private sector jobs. The 503 program, which addresses the need of small businesses for long-term capital to expand and grow, is just this sort of program.

Since its inception in 1980, the SBA has approved loans under the 503 program totaling $150 million. These loans have provided over 30,000 jobs. Under the program, the average cost to the Government per job has been less than $5,000. This is an impressive record. Unfortunately, the program has not yet reached its full potential.

The legislation being considered at today's hearing is in direct response to testimony received at the oversight hearing on SBA's economic development program held by this committee on September 28, 1982. At that time, the 503 program was widely praised as a fine example of the type of public-private partnerships so vital to America's economic recovery. The witnesses were unanimous in their commitment to maintaining and strengthening the program.

It was clear, however, that one of the major impediments to the 503 program's growth has been the refusal of the administration, in direct contradiction of clearly expressed congressional intent, to participate in 503 projects whose other sources of financing include, or are collateralized by, tax-exempt industrial development bonds.

Today's witnesses will comment on the legislation which will codify the congressional intent. I look forward to reviewing their comments.

STATEMENT OF HON. JAMES R. SASSER, A U.S. SENATOR FROM THE STATE OF TENNESSEE

Mr. Chairman, I applaud the Senate Committee on Small Business taking action to oppose the Administration's exclusion of tax-exempt financing in the Small Business Administration's Section 503 Certified Development Company program. During past oversight hearings on the S.B.A.'s Economic Development program, the 503 program was hailed as an excellent example of the public-private cooperation that is essential to our economic recovery. Yet it was equally clear during those hearings that one hurdle to the growth of this program is the Administration's continued refusal to participate in 503 programs when other sources of financing for the project include tax-exempt industrial development bonds.

We are all aware of the contribution of small businesses to job creation. Tennessee's small businesses produce roughly half of the State's goods and services. These firms contribute about 45 percent of the State's total payroll. In addition, firms with less than 100 employees constitute over 75 percent of the manufacturing, construction, service and finance companies in our State.

While the 503 program is still very young in Tennessee, it is having a positive impact on the State's economy. We currently have four active certified development companies in Chattanooga, Knoxville, Columbia and Cookville, Tennessee. A group in Nashville is currently putting together another such company. The Knoxville 503 company has an approved request with the S.B.A. that will create 36 new jobs.

I can't help but wonder Mr. Chairman, whether we would be experiencing more participation in this worthwhile program in Tennessee if we weren't experiencing these difficulties with Industrial Development Bond (IDB) financing.

The Administration's position on this issue is quite confusing given the past legislative history in this area. The Certified Development Company was enacted as part of Public Law 96-302. The Conference report to that measure stated quite clearly that the S.B.A. shall not disapprove debentures under the 503 program solely because other sources of financing include tax-exempt industrial revenue or development bonds. Indeed, the S.B.A. has even promulgated regulations that are consistent with this declaration of Congressional intent.

Yet, this Administration has urged the S.B.A. to ignore the clear intent of Congress and thereby deny assistance to those who were designated to benefit from the 503 program. As was evident in the testimony in our September hearings, this deci-

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sion has resulted in situations where small businesses have not gone ahead with expansion projects because the 503 funding could not be combined with IDB's.

Mr. Chairman, we have a national unemployment problem that is rocking the economic foundations of our country. We are not well served by the Administration's efforts to curtail the section 503 program. I commend the Committee's actions in looking into this problem and hope to see expeditious action on this important matter.

Senator D'AMATO. Senator Tsongas, do you have any opening remarks?

STATEMENT OF HON. PAUL E. TSONGAS, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Senator TSONGAS. Let me say at the outset, I wish you Democrats would stop criticizing the administration. [Laughter.]

I mean, those kinds of highly partisan attacks are just not appropriate in this day and age.

I agree with everything you said. In an attempt to be bipartisan, let me associate myself with your remarks.

The only comment I would make is that which the chairman referred to. We do a lot of work in Massachusetts trying to get downtowns revitalized, trying to get industry moving and trying to bring about a reasonable economic climate. Here you have these remarkable vehicles, that have been shown to be successful, and they are underfunded or there are regulatory problems about their use.

Then you pick up the newspaper, and we are going to spend between $4.3 and $7 billion on a jobs program. It is a clear case of the left hand not knowing what the right hand is doing. These are not only good programs but they are also good economics and, I would argue with you, better than a jobs bill.

Therefore, it seems to me that it would also be good Republican economics to push these programs instead of—not instead of but perhaps even more strongly than—the ones they have proposed to the Congress. Since programs like this are simply using public money to leverage in private sector investment, it seems so utterly logical that it is really a wonder why we have to even have this hearing.

I commend the chairman on his initiative. I cosponsored the bill, and hopefully we can get it passed through the Congress in very rapid fashion.

[Material follows:]

STATEMENT OF HON. PAUL E. TSONGAS, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

I am pleased to join Senator D'Amato and my colleagues in this hearing, and in cosponsoring legislation to require the use of IDBs in conjunction with our 503 loan program.

Massachusetts is very active in the 503 program, and at this point we have 18 certifications, and have received $6.5 million in loans. The program is working, and is a classic example of the type of public/private partnership that we are working hard to develop, in order to help the economic recovery.

The flaw in the program, however, is the lack of ability to tie in with Industrial Development Bonds. Despite strong Congressional mandate to permit the use of IDB financing in conjunction with 503 loans, the Administration has chosen to prohibit this joint financing by administrative fiat. The D'Amato bill will correct that problem, and give the 503 program the added strength that it needs to make the program workable.

We have today a distinguished witness from Massachusetts, who is well qualified to speak on this issue. Mr. William Kelley, President of the Hancock Bank and

Trust of Quincy, Mass., represents not only the wisdom of the financial community, but the hands-on realities of making economic development work in the business community. I welcome him, and look forward to hearing his views.

Senator D'AMATO. Thank you very much, Senator Tsongas.

Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman. I ask only that my statement be included in the record at this point.

[Material follows:]

STATEMENT OF HON. CARL LEVIN, A U.S. SENATOR FROM THE STATE OF MICHIGAN

Mr. Chairman, I want to commend you for your leadership in focusing the attention of this Committee on the Reagan Administration's policy decision which has restricted small business access to tax-exempt financing in connection with SBA guarantees, in direct contravention of express Congressional intent. Two important programs administered by SBA are affected by this prohibition: the Pollution Control Bond Guarantee program and the Section 503 Certified Development Company program, on which we will receive testimony today.

When these two programs were established, Congress specifically intended that the SBA have the authority to guarantee tax-exempt obligations. In the Conference Report accompanying Public Law 96-302, which established the Section 503 program, it states: "SBA should not disapprove the guarantee of any debenture or any loan made with the proceeds of a debenture issue, solely because the proceeds would be used in a project whose other sources of financing include, or are collateralized by, tax-exempt industrial revenue or development bonds." Moreover, SBA's regulations, at 13 CFR 108.503-4(c), state: ". . . SBA may participate in projects whose other sources of financing include, or are collaterized by tax-exempt obligations. Further, loans made with the proceeds of 503 debentures may be subordinated to such obligations."

Public Law 94-305, which established the Pollution Control Bond Gurantee program, contains specific statutory authority on this point. The Small Business Investment Act of 1958, as amended by Public Law 94-305, at Section 404(b)(1) states: "Notwithstanding any other law, rule, or regulation or fiscal policy to the contrary, the guarantee authorized in the case of pollution control facilities or property may be issued when such property is acquired by the use of proceeds from industrial revenue bonds which provide the holders interest which is exempt from Federal income tax."

Nevertheless, the goals of the Section 503 have been hampered, and the Pollution Control Bond Guarantee program has been practically shut down, by the OMBC's policy directive which prohibits the SBA from providing direct or indirect guarantees of tax-exempt obligations. At a time when we should be providing as much help as we can to small business to expand, meet pollution control requirements, and create jobs in our local communities, the OMB's policy is thwarting these objectives.

OMB appears to be enforcing its policy based upon the fact that the Section 503 regulations, the language of Section 404 of the Small Business Investment Act, is "permissive"; thus, SBA has the option of deciding whether or not to provide guarantees in connection with tax-exempt obligations. Yet, Congress clearly intended that SBA do so.

The issue here is not the wisdom of providing direct or indirect guarantees of tax-exempt obligations. That decision was made by Congress with passage of Public Law 96-302 and Public Law 94-305, and I happen to believe it was a good decision. Rather, the issue here is Executive Branch execution of the laws enacted by Congress.

OMB's policy and SBA's non-compliance with the Congressional intent is a situation that we as a Committee, and as members of this Congress, should not tolerate.

The legislation proposed by Senator D'Amato is a necesssary action resulting from the OMB's policy. It would direct that SBA "shall not decline" to participate in a Section 503 project where some of the financing for the project is derived from tax-exempt obligations. I believe a similar legislative change should also be made with respect to the Pollution Control Bond Guarantee program.

It is my hope the Committee will move swiftly to adopt such legislation.

Thank you.

Senator D'AMATO. Well, then, why don't we get to our first witness, Mr. Holloway, and make note that we just received Mr. Holloway's remarks about noon today.

Were you scrambling to come up with justification as to why we shouldn't go forward with this legislation, Mr. Holloway? I think, as I understand some of your remarks, you must have been working late into the evening coming up with them.

STATEMENT OF EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY CHARLES HERTZBERG, DEPUTY ASSOCIATE ADMINISTRATOR FOR FINANCIAL ASSISTANCE, AND WAYNE FOREN, DIRECTOR, OFFICE OF LENDER RELATIONS AND CERTIFICATION

Mr. HOLLOWAY. Mr. Chairman, I thank you very much for the opportunity to be here to discuss a program that I believe the executive branch and the legislative branch share a mutual enthusiasm for.

Senator D'AMATO. Mr. Holloway, the executive branch would love to do away with it, is that not so?

Mr. HOLLOWAY. No.

Senator D'AMATO. Maybe you wouldn't. That would be the end of your job.

Mr. HOLLOWAY. We really wouldn't. We do like this program.

Senator, I am accompanied today by Mr. Charles Hertzberg, the Deputy Associate Administrator for Financial Assistance, and Mr. Wayne Foren, who is the Director of the Office of Lender Relations and Certification, the office directly in charge of the 503 program.

I do appreciate the opportunity to appear before you again today, Senator, to discuss S. 499, which would amend section 503 of the Small Business Investment Act of 1958.

The 503 program is one of the Government's principal economic development tools to assist communities, both urban and rural. It is intended to stimulate the growth and expansion of small businesses and to create jobs through a unique partnership between the Federal Government and certified development companies, which include State and local government and the private sector. SBA guarantees debentures of CDC's, which in turn use the proceeds to assist small business concerns by financing parts of long-term, fixed-asset projects.

The debentures are sold to the Federal Financing Bank for a term of 15 to 25 years. They bear a rate equal to the Federal Financing Bank rate plus approximately 1 percent for servicing. Typically, the debentures provide permanent financing for 40 percent of the project cost, which is subordinated to a first mortgage of 50 percent of the project cost provided by a private sector lender. The CDC, or small business, provides the remaining 10 percent.

S. 499 would amend section 503 of the Small Business Investment Act, providing that: One, SBA shall not decline to participate in a project under section 503 which otherwise meets the requirements of that section because other sources of financing for the project include or are collateralized by obligations described in section 103(b) of the Internal Revenue Code of 1954; two, loans made

with the proceeds of debentures guaranteed under section 503 may be subordinated to other obligations; and, three, SBA and any other agency of the Federal Government shall not restrict the use of debentures guaranteed under section 503 with obligations described in section 103(b) of the Internal Revenue Code of 1954 if the project being so financed otherwise complies with the regulations and procedures of SBA.

Under current law, development company debentures may be used to provide funding for up to 50 percent of the cost of a project. The intent of S. 499 is to permit financing for the senior lien position, private sector half, to come from tax-exempt industrial revenue bonds, thus overturning current Federal policy.

As we indicated last September in commenting upon similar legislation contained in the House-passed version of S. 1947, the practical effect of such a proposal would result in an SBA guarantee of the tax-exempt financing. In a typical transaction, SBA is in a second-lien position; the non-SBA portion has a first lien. In order to protect its second lien, SBA would be, in effect, guaranteeing repayment of a tax-exempt bond. For reasons well known to the committee, it is a longstanding executive branch policy to oppose such double subsidy.

The position we enunciated last September remains unchanged. We do not oppose participation in projects where the source of financing other than the guaranteed debenture is from tax-exempt industrial revenue or development bonds. Rather, our opposition occurs when the financing is in a senior lien position to the SBA-guaranteed debenture.

We indicated to you last time that we were prepared to clarify our regulations and procedures to allow participation so long as the SBA-guaranteed debenture is in at least a parity position. This will allow small business to have access to tax-exempt financing and SBA-guaranteed debentures for the same project.

We have pending a proposed rule that would permit certified development companies to finance projects with the proceeds of SBA-guaranteed debentures and tax-exempt obligations, provided that the latter are on a parity level or subordinated to the repayment of the former.

As of December 31, 1982, there were 339 certified development companies and another 45 applications for certification in process in the central office. As of that date, 833 loans had been approved for a total of $150 million, resulting in 35,000 employment opportunities—jobs created or retained. In addition to the 503 debentures, $225 million of private sector and other resources have been invested.

During the first three months of fiscal year 1983, there were 174 loans approved for a total $34 million. Also during that period, the new small business revitalization program was initiated in 21 States. This is a joint initiative with HUD and to a great extent utilizes the CDC and the 503 program.

Considering the expected growth in the 503 program and the impact of the SBR program, we believe the activity in fiscal 1983 will achieve the $250 million budgeted program level. This, of course, includes limited 502 program activity which is not expected to exceed $25 million.

During the last few months, there has been an indication that there are opportunities for participation in projects where the 503 assistance is in a parity or senior position to the tax-exempt obligations.

For example, a certified development company in New York—the Long Island Local Development Co.—has four projects pending totaling $2 million where the New York Jobs Development Authority would provide financing from tax-exempt obligations on a parity basis with the 503 assistance. If approved, these projects would involve a combination of financing as set forth in the written statement—approximately 50 percent 503, 40 percent tax-exempt obligations, and 10 percent from the small business concerns.

In another instance, the 503 assistance will be in a senior position to the tax-exempt obligations. In the State of Maine, the potato industry is having considerable difficulty because of inadequate storage facilities and the need for improved temperature control.

To address the problem, the State passed a bond issue in November 1981, designating $5 million to fund construction and rehabilitation of potato storage and packing facilities. This is a general obligation of the State, and tax-exempt—both Federal and State.

Efforts are being made to finance these projects in part with the 503 program; however, the 503 debenture will be in a senior position. This effort would make a major impact in solving a critical problem in a key industry in the State.

In your letter of invitation, Mr. Chairman, you asked that SBA testify as to the likely impact of this legislation on the 503 program. We do not believe that the legislation is necessary to promote the growth of the 503 program.

We believe this for two reasons: First, even without tax-exempt IRB——

Senator D'AMATO. Excuse me.

Mr. HOLLOWAY. Yes, sir.

Senator D'AMATO. Excuse me. By the way, I want to compliment you. You read your testimony with such feeling.

However, the first reason would probably be Mr. Stockman, and the second reason would be Mr. Stockman, and the third reason would be Mr. Stockman. You tell me the two reasons now why you don't think it is necessary.

Mr. HOLLOWAY. Yes, sir. First, even without tax-exempt IRB financing, the program is growing and doing very well. There is tremendous interest in the program across the country under the present rules. We have managed this new program with the goal of promoting maximum feasible economic development and job creation consistent with prudent program management. Second, even without the formal publication of a rule, we have evidence of interest in 503 assistance combined with tax-exempt obligations in a nonsenior lien position.

Finally, we continue to search for creative ways to make the program even more useful to small business.

Mr. Chairman, this concludes my prepared remarks. I would be pleased to answer any questions that I can.

Senator D'AMATO. Thank you very much, Mr. Holloway.

Why don't we start with what your last conclusions were with respect to the parity situation, where you said it is not needed because parity proposals which were announced last September have already come into existence. You then cited that in New York there were four cases where this was taking place.

Now I have been given to understand that in the 5 months since our September hearing, with respect to the parity proposal, there still have not been officially formulated any regulations and that the four projects you cite on Long Island are still pending, with no guarantee that they will work utilizing the method that has been suggested.

I believe that the witnesses that follow—and I hope you stay to listen to them because they are the people that you have certified as CDC's. They are the recognized experts that you take credit for if they do a good job. I think it is important to listen to what they have to say. I think they are going to testify to the inordinate difficulties in attempting to even set up the procedures vis-a-vis the parity proposal, and that a third and essential feature of these four projects is the fact that the SBA has increased the CDC guarantee authority to 50 percent of the project cost from the customary 40 percent of the project cost—just a little added inducement to keep it moving, even though this violates the SBA's own regulations.

Consequently, in the 5 months since the parity proposal was announced, not one single project has been approved. Only a handful are pending; these handfuls require exceptions to SBA's normal operating procedures, and those involved in trying to put these projects together say that they face inordinate difficulties and do not think they are ever going to be successful.

Therefore, why would you come to this committee and talk about this parity system when it is clearly leading us to a blind alley?

Mr. HOLLOWAY. Senator, as you know the law does provide—as do our regulations—that up to 50 percent is permitted for the 503 debenture. Typically the 503 debenture is 40 percent in a transaction. However, our district directors have authority in the standard operating procedures to make an exception and go up to 50 percent.

Senator D'AMATO. However, you have been doing 40 percent.

Mr. HOLLOWAY. We have been doing 40 percent and it is my understanding, Senator, that for the New York Jobs Development Authority, their regulations limit them to 40 percent. I believe Mr. Gurian may testify that there are in the works attempts to increase their authority to 50 percent. It is my understanding that there is a limitation of 50 percent, and the 50 percent provided by SBA extends our authority to its limit to; help accommodate that.

Senator D'AMATO. You don't have one parity situation nationwide in the last 5 months, not one, and yet you're coming here and saying, "Don't enact this bill." We think we can come around with this parity situation, in which bankers have testified that they are not going to be participating, of which they are very doubtful."

Therefore, when you come here and say, "Please don't do this," 5 months have gone by and nationwide there is not one loan given using this parity system. Is that true?

Mr. HOLLOWAY. Senator, it is true that none have been approved. But it is also true that we fully expect to use the $250 million we have to operate this program this year.

Senator D'AMATO. Well, how much did you not use last year?

Mr. HOLLOWAY. We used $99.6 million last year. What was the total amount? It was $150 million, so we did not use about $50 million. As you are aware, Senator, this particular type of program has a long pipeline to it, from the planning stage to construction loans to final completion of the facilities and takeout on permanent financing.

We now have about 339 CDC's approved. Before this year is over we will have something like 400. We see every quarter the use of the program going up, and really are quite enthusiastic——

Senator D'AMATO. The cost per job is going down?

Mr. HOLLOWAY. Around $4,000.

Senator D'AMATO. It is going down every quarter?

Mr. HOLLOWAY. I would not want to say that, Senator? It is hanging around $3,800 to $4,000 per job.

Senator D'AMATO. Well, we need jobs, don't we?

Mr. HOLLOWAY. Yes, sir.

Senator D'AMATO. Why not use IDB's to stimulate job creation? Wouldn't IDB's help stimulate this? Wouldn't they free up other private capital in other areas?

Mr. HOLLOWAY. Senator, as you are aware from your September hearings, Assistant Secretary Roger Mehle appeared here and made a matter of record the objections of the Treasury Department to the use of the tax-exempt industrial development bonds in a position that is guaranteed directly or indirectly by the Federal Government.

Senator D'AMATO. Well, you are not guaranteeing the industrial revenue bonds and it is not a double subsidy. IDB involvement in the 503 package does not result in the Federal guarantee of the IDB. That is convoluted thinking. It just does not, and for you to come up here and say that it does is at variance with the facts. I wish you wouldn't perpetuate that kind of illogical thinking because it is at variance with the facts.

If you want to say that you got your marching orders to come up here and say, "No, we don't want to use it," and that "We think we are going to use our moneys," when you have had as much as $150 million not utilized, fine. How, when there are good applications pending—I am not talking about ones that should not qualify under banking standards, but good applications that could be acted upon that are not acted upon as a result of this kind of intransigence—how then can you not act? I think that we now have an obligation to enact this legislation.

Mr. HOLLOWAY. Senator, I appreciate the perspective that you have on it and I know you can build a good case. However, I do think that it is clear that when there is a loss to be taken in these transactions, we will take that loss in the second mortgage position, and we will take that loss so that the first mortgage can be paid out. I do not believe it is convoluted thinking to think of the indirect guarantee as being a reality in the way these transactions work out when they go into default. The first mortgage people get their money and we do not.

Senator D'AMATO. Let me simply say this to you: We have never had a default in this program yet, have we?

Mr. HOLLOWAY. Yes, sir, Senator, we have had a default. We have not had many, and of course we have not had much in the way of losses, and we fully expect to operate this program with modest losses.

Senator D'AMATO. Well, I have a report here that shows one default, and actually it is no defaults: "The status of the 503 portfolio, debentures sold to FFB through September, 1982." Now maybe you have had one since then.

Mr. HOLLOWAY. In December—1983 information—we show three loans that are in a past-due status.

Senator D'AMATO. Oh, past-due status.

Mr. HOLLOWAY. Past due.

Senator D'AMATO. Have you had any defaults?

Mr. HOLLOWAY. Well, that is a default, Senator.

Senator D'AMATO. Well, you have three loans total, nationwide, in a past-due status.

Mr. HOLLOWAY. Out of 387, yes, sir.

Senator D'AMATO. Out of 387; 1 percent. If your other programs ran this well, we would be in good shape, wouldn't we?

Mr. HOLLOWAY. Well, we are making every effort to operate this program——

Senator D'AMATO. We are not asking you to lower your standards in terms of qualifications.

Mr. HOLLOWAY. I understand, sir.

Senator D'AMATO. We are saying to you, "Use that money that Congress provided, and don't use what we consider to be a convoluted theory that goes back to 1965 in restricting IDB's."

Senator Tsongas, do you have any questions?

Senator TSONGAS. If I gave you $1 billion to create jobs, would you put it into a public service or public works program or would you expand programs like 503, IDB's, UDAG? What would you do?

Mr. HOLLOWAY. Senator, I believe a program such as the 503 program is an ideal way to utilize money in job creation.

Senator TSONGAS. Well, you say it costs $4,000 a job, which apparently has been the experience. UDAG is something like $6,000, if I remember right. In public works bills you are probably talking $15,000-plus. If those numbers are as valid as people would suggest, then it seems to me you can get almost four times as many jobs through a 503 program than you can from the kind of jobs bill we are talking now. Is that not correct?

Mr. HOLLOWAY. Senator, my knowledge does not extend to the overall Government picture on job creation, and I really should restrict my remarks to your question about the effectiveness of the 503 program, which we believe to be very effective.

Senator TSONGAS. Now I can understand your answer, in terms of not wanting to get involved in the controversy. I may be beating a dead horse, but I have the strong feeling—and it seems obvious on its face—that if jobs are what we are after and this is the most efficient way of leveraging the private sector, then the administration should be banging on us trying to expand it, not being reluctant about our attempts to do the expansion.

The problem we have here is, we are talking to the already convinced. You are right, the decisions are being made by Stockman and others, and unfortunately he is not the one testifying before the committee.

Let me raise a subsidiary issue with you, if I can. We do a lot of work trying to interest business in my State in your programs, and we have a number of companies—three of them in particular—that have been working with SBA. By the way, you have an excellent staff in the Boston area. We finally have these people interested. They make their investment decisions accordingly, and all of a sudden, as you know, moneys have dried up in terms of the funding of the second quarter. What are we supposed to tell these people?

Mr. HOLLOWAY. Senator, we have adequate funding available for this program and have had through the first quarter and the second quarter.

Senator TSONGAS. No; I am not talking 503. I am talking about your direct loan program. Are you telling me you have enough money in the direct loan program for all the applications that have been funded and approved?

Mr. HOLLOWAY. The President, as you know, did not propose in his fiscal 1984 budget money for direct loans other than in the MESBIC program, so at the present time it is my understanding that a deferral request is pending with the Congress vis-a-vis the moneys, appropriated moneys, available.

Senator TSONGAS. The President's proposal starts in fiscal year 1984.

Mr. HOLLOWAY. And amended fiscal year 1983, sir.

Senator TSONGAS. Staff advises me, and this must be the answer, that it is the deferral in fiscal year 1983 that has caused the stoppage of funds.

How do you argue with the private sector that Government knows what it is doing if you go through all the steps to try to get them to move in a particular direction, and then by deferral or recommendation in the ensuing fiscal year you simply stop the program? Isn't there some sense of obligation, that if we are going to woo people into this posture, that we consummate the deal?

Mr. HOLLOWAY. We believe, Senator, we can do the job with the guarantee program, and that is the thrust of our activity in any event. Over 85 or 90 percent of all of our activity is under the guarantee program, and we believe we can do the job with the guarantee program.

Senator TSONGAS. OK. I will submit to you the names of these particular three companies, and we will see next time around whether indeed that has been the case. I just feel very badly, since we have a very aggressive outreach program—and your agency is a part of that—to have done all that work and then be in an embarrassing position of looking like we in essence pursued the options that you make available and you then turn around and say, "Well, we just can't do it."

Well, we have a lot of witnesses and I will not be able to stay through all of it, so I will relinquish the balance of my time, Mr. Chairman. I commend you on the initiative and join you in cosponsoring your bill.

Senator D'AMATO. Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman. I also join in commending you for initiating these hearings and continuing this process that you are so deeply involved in.

Do I understand that the SBA may participate in projects whose other source of financing includes or is collateralized by tax-exempt obligations?

Mr. HOLLOWAY. That was a change, Senator, in the Treasury's testimony of September 29 or 28, I believe, but prior to that time they had not had, as a Federal credit policy, permission to participate where the tax-exempt bonds were involved. However, as of the last hearings they did in their testimony agree to permit us to participate where we were in a parity or better position but not in a subordinated position.

Senator LEVIN. I understand, but is it—and I want to read this again, I want to read all the language—is this true or false?

"SBA may participate in projects whose other source of financing include or are collateralized by tax-exempt obligations. Further, loans made with the proceeds of 503 debentures may be subordinated to such obligations."

True or false?

Mr. HOLLOWAY. It is false because of the last sentence.

Senator LEVIN. I am reading your regulations.

Mr. HOLLOWAY. Senator, as you may recall from the last hearings, it was made a matter of record at that time when I believe Senator D'Amato entered into the record a memorandum from the Office of Management and Budget that permitted us to continue the funding of the program, provided that we did not——

Senator LEVIN. Mr. Holloway, I am reading to you from what I consider to be the laws of the land. I am familiar with that OMB memo.

Mr. HOLLOWAY. Right.

Senator LEVIN. Regulations are the laws of the land. This was a regulation made pursuant to law, I presume, wasn't it?

Mr. HOLLOWAY. I believe it was, Senator.

Senator LEVIN. You did not act lawlessly when you adopted this regulation, did you?

Mr. HOLLOWAY. No, sir.

Senator LEVIN. You wouldn't do a thing like that. Your regulation, made pursuant to the laws of the land and therefore part of the laws of the land, says that loans made with the proceeds of 503 debentures may be subordinated to such obligations. Now you are telling me that a memo from the OMB is now superior to this?

Mr. HOLLOWAY. I am only telling you, Senator, that to commit the funds of the United States, I have to have an apportionment to do it from the Office of Management and Budget and to comply with all the terms and conditions of that apportionment.

Senator LEVIN. Do you take your directives from the Congress or the OMB?

Mr. HOLLOWAY. As a part of the executive branch of the Government, my directives come from the White House.

Senator LEVIN. Therefore, if the OMB tells you you may not do something which the Congress says you may do, you follow the directive from the White House?

Mr. HOLLOWAY. I do not obligate money that is not apportioned to me by the OMB.

Senator LEVIN. If the law of the land says that you may do something and OMB says you may not, you take the OMB?

Mr. HOLLOWAY. They are a higher authority in the executive branch than I am, Senator, and I do——

Senator LEVIN. Have you received a legal opinion as to whether you are now acting lawfully or lawlessly? Has your lawyer advised you on this issue?

Mr. HOLLOWAY. I don't have an opinion on that specific, narrow point, Senator. However, it is clear that I have no authority to commit the United States beyond the funding level that I am given, apportioned from the OMB and according to the terms and conditions of the apportionment.

Senator LEVIN. But for that directive by the OMB, I presume you would follow your own regulations?

Mr. HOLLOWAY. Yes, sir.

Senator LEVIN. You have not changed that regulation, have you?

Mr. HOLLOWAY. We have a proposal that is pending at OMB to change——

Senator LEVIN. However, you have not yet changed that regulation?

Mr. HOLLOWAY. It is not changed in final, no, sir.

Senator LEVIN. It is not even a proposed change, is it?

Mr. HOLLOWAY. Yes, sir, it is pending at OMB. It is not in the Federal Register yet.

Senator LEVIN. No; I am talking about publishing a proposed regulation.

Mr. HOLLOWAY. It is not in the Federal Register yet.

Senator LEVIN. Now the Small Business Investment Act of 1958 says:

> Notwithstanding any other law, rule, or regulation, or fiscal policy to the contrary, a guarantee authorized in the case of pollution control facilities or property may be issued when such property is acquired by the use of proceeds from industrial revenue bonds which provide the holders interest which is exempt from Federal income tax.

Are you familiar with that section?

Mr. HOLLOWAY. Yes, sir, I am familiar, Senator.

Senator LEVIN. That specifically says that you may issue such guarantees even though the interest is exempt from Federal income tax. Is that right?

Mr. HOLLOWAY. Yes, sir.

Senator LEVIN. OMB has told you that you may not.

Mr. HOLLOWAY. The apportionment that I have does not permit me to obligate the funds of the United States on that basis, sir.

Senator LEVIN. The OMB has told you you may not.

Mr. HOLLOWAY. The apportionment that I have, Senator, does not permit me to do that.

Senator LEVIN. OMB wrote the apportionment.

Mr. HOLLOWAY. That is correct. They approved it.

Senator LEVIN. OMB told you you may not do something which Congress told you you may do. Isn't that what it really comes down to?

Mr. HOLLOWAY. Senator, I can see that interpretation.

Senator LEVIN. Can you see any other interpretation?

Mr. HOLLOWAY. Yes, sir, I can see the interpretation that as an official of the United States, I will not commit the funds of the United States outside the authority that I have.

Senator LEVIN. Of course, of course. I am asking: Do you see any other interpretation than OMB has told you you may not do something which the Congress has told you you may do?

Mr. HOLLOWAY. That is a fair interpretation, and I am in the executive branch.

Senator LEVIN. I appreciate that, and I know at the moment you appreciate that. [Laughter.]

I want to ask you a question. It is just a commonsense, direct question.

Mr. HOLLOWAY. Sure.

Senator LEVIN. Is it not clear that the OMB has in effect told you you may not do something which the Congress has told you you may do?

Mr. HOLLOWAY. That is correct.

Senator LEVIN. Mr. Chairman, I support what you are doing but I must tell you, I think it is an outrage that you have to do it.

Senator D'AMATO. I agree.

Senator LEVIN. We are either going to be a government of laws or a government operated by the OMB. Now the lawmakers in this Government have clearly said—at least in the Small Business Investment Act on pollution control bonds but I think also across the board—what congressional intent is. It is in writing that we have authorized you to do something; OMB has told you you may not, and that means that the OMB has taken over the legislative power of this country.

Now I think they have taken over too much of the executive power of this country, and that is a different issue for a different committee. We have taken up that issue on the floor in terms of how much power has been taken over by OMB and given OMB by Executive order, but in this case I think OMB is usurping the legislative power of this country because Congress has—certainly on pollution control, and I think all of these debentures—flat out authorized you to do something which OMB says you may not do. That, to me, means they are directly contradicting congressional legislation and intent.

I think that there is a deeper issue here than the merits of this, although it is very meritorious—and I wouldn't want to deflect what you are doing, Mr. Chairman. I think you are on the right track and we probably have no alternative. But, there is a deeper issue and I am hoping that if this committee does not take it up, that other committees of the Congress will. I think it is a fundamental issue in terms of powers. I think there has been an abuse, and a usurpation of it. I think it is unconscionable that we permit the executive branch—I don't care whether it is OMB or any other part of the executive branch—to in effect usurp the legislative authority, unless they want to argue it is unconstitutional.

I have not seen any opinion that this is unconstitutional. Now if they want to argue it is unconstitutional, that is something else, but I have not seen any such suggestion. Therefore, I do hope that we will proceed on the course you are on, Mr. Chairman, but at the

same time alert our colleagues in other committees that this issue should be reviewed for the underlying question that it raises.

Mr. Holloway, you are caught in the middle, and I am not trying to suggest that you can countermand your directives or your apportionment from OMB. I am not suggesting that at all. What I am suggesting I think was clear in terms of the abuse here by the OMB.

Senator D'AMATO. Senator Huddleston?

STATEMENT OF HON. WALTER D. HUDDLESTON, A U.S. SENATOR FROM THE STATE OF KENTUCKY

Senator HUDDLESTON. Thank you very much, Mr. Chairman. I regret that I was a little late in the beginning of this. It seems you have covered the subject pretty well already.

I would ask that a statement of mine be included in the record at the appropriate point, and I too commend you for calling the hearings and for the legislation that you introduced yesterday and I cosponsored, that would prohibit the administration from excluding the use of tax-exempt financing in connection with the 503 program.

I think all of us realize that job creation and the enhancement of business activity is a major objective right now. I am a long supporter of the 503 program. I think the SBA has been, too, and believes that it is a good program.

I think it is unfortunate, too, that we have to spell out again in law precisely how it is going to be administered so that it will not be handicapped. It seems to me that by giving the 503 program this ability to use tax-exempt financing, we are elevating small business in some little degree up to what big business is engaged in in using Federal programs.

We know that more jobs are created by small business, and have been over the last decades, than by big business. It seems to me that by concentrating our efforts there, and to some degree at least trying to put them on an even footing, we can maybe help create some additional jobs.

Without going into any further detail, Mr. Chairman, other than to endorse what you are trying to do, I will yield.

[Material follows:]

STATEMENT OF HON. WALTER D. HUDDLESTON, A U.S. SENATOR FROM THE STATE OF KENTUCKY

Mr. Chairman (Senator D'Amato), I commend you for calling this hearing today on the use of tax-exempt financing in conjunction with the small business 503 financing program. The leadership you have exercised in this particular area of financing is greatly appreciated by those of us who recognize its value to the small business community.

I am proud to be a cosponsor of the bill you introduced yesterday which would prohibit the administration from excluding the usage of tax-exempt financing in connection with the 503 program. We have joined together in the past to protect the crucial area of tax-exempt financing and I am certain that, with this Administration's track record on the issue, we will fight similar battles in the future.

On September 28, 1982 the Small Business Committee held its first formal oversight hearing on the 503 certified development company program. As a strong supporter of the 503 program from its inception, I was extremely pleased to hear the praise which was used to describe the success of the program. Although it is true that the program will need some fine tuning, it is off to an excellent start and is desperately needed.

Even though interest rates have come down a little, they are still excessive and business bankruptcies are still occurring in record numbers. However, if we allow the 503 programs to grow to its full potential, it can play an increasingly important role by providing the small business sector with affordable capital. The increased investment generated by the program can help lead us out of the deep recession the economy has been mired in since 1981.

I know the value of the 503 program from first-hand experience in my state. Kentucky has one state-wide certified development company and 8 local 503 programs. In addition, several petitions for certification are pending. Even though these programs have been in existence for a relatively short period of time, they have helped finance projects that have created or helped save over a thousand jobs in Kentucky.

Mr. Chairman, at a time when this country needs to create millions of new jobs, I cannot understand the Administration's opposition to the full development of a loan program which will create jobs. And, this is exactly what the Administration is doing when it orders the SBA to refuse to guarantee or participate in 503 loans for projects in which industrial development bond financing is used.

Unfortunately, this particular obstacle is but one part of a broader Administration policy which is designed to gut the small-issue industrial development bond progam. This policy is being pursued without any regard for the productive projects and increased employment which can be generated by the responsible use of IDBs.

The aspect of this particular obstruction which disturbs me the most is that this policy is in opposition to the intent of Congress. Our intent was made clear in the conference report in PL 96-302 where it was stated that: "SBA should not disapprove the guarantee of any debenture or any loan made with the proceeds of a debenture issue, solely because the proceeds would be used in a project whose other sources of financing include, or are collaterized by, tax-exempt industrial revenue or development bonds."

Since the Administration chooses to ignore this explicit direction from Congress, we are left with no other option than that proposed by the legislation introduced yesterday.

Mr. Chairman, I look forward to the testimony we will receive today. Of particular interest to me is the testimony which will be offered by Robert Bowman who is Commissioner of Economic Development for the City of Louisville. The city has one of the most active programs in the state and I am certain that he will be able to provide us with a great deal of insight on this issue.

Senator D'AMATO. Do any other members of the committee have any other questions or statements or observations?

Senator TSONGAS. Does the chairman have any idea what kind of timetable he would pursue on this?

Senator D'AMATO. I think we will go right to markup as quickly as we can. I would hope that maybe within the next 10 days to 2 weeks would be a fair objective, maybe sooner. I have every reason to believe we will be able to go to a markup with this rather quickly.

Senator TSONGAS. I would like to have this considered by the Senate before the jobs bill. I think it gives us a marvelous window to argue that this legislation is fully consistent with the Senate's interest in the pending legislation; that is, the jobs bill.

Senator D'AMATO. I concur. I think it is an excellent idea. Let me just see how quickly we can do it. I think we will be able to go through it rather quickly. I will speak to the chairman of the full committee, who I know is deeply interested in this. Senator Weicker has indicated his strong support for our movement in this area, so I think we will be able to go to a markup rather quickly, as soon as we conclude these hearings, because I think it is evident that unfortunately it will be necessary for us to move in this manner.

Going back to our hearings of September 28, going back to the history of attempting to work this out through negotiations, both with Treasury and with Mr. Stockman, the fact that we asked Mr.

Stockman to appear and he did not, and he said he could not and he was busy at that time—and obviously, he is on his honeymoon now and so obviously he could not be here—but I am wondering, if he was not on his honeymoon, if he would be here in any event? I do not think so.

I also think that Senator Levin has made some very cogent observations. This is not an isolated instance where OMB, through its own actions, has thwarted the will and the legislative intent of Congress and the law, the law of the Congress and the law of the land. We need just look through the Transportation Appropriations Act, and we see that although we went through an agonizing, torturing procedure through the lameduck session, allocated 5 cents for the gasoline tax and 1 penny for mass transit, only to see that authorized amount cut by 69 percent in their budget request. We just went through an exercise 30 days ago, a little more than 30 days ago. The President signed a bill, and yet that is what took place, and that again came through OMB.

Therefore, I have to share Senator Levin's feelings that there is somebody up there who says, "Well, we don't care what the Congress did or what the law of the land is, we know what is good for you. We will do it even if we have to refer to a 1965 OMB circular, A-70, in this particular case and use that as our authority to thwart the use of tax-free bonds, industrial revenue bonds."

Therefore, I share your feeling that unless we move on this and quickly—and I think we do have a window of opportunity to do that before the jobs bill, and I can assure my colleagues that that will be my thought——

Senator LEVIN. Mr. Chairman, on Senator Tsongas' point, I understand there has been a deferral requested by the administration of some direct loans funds and some loan guarantee authority. Is that accurate?

Mr. HOLLOWAY. Yes, sir.

Senator LEVIN. Do you know whether or not, as part of the so-called jobs package that you are trying to work out with the House, the administration is going to withdraw all or part of that deferral request?

Mr. HOLLOWAY. I have no knowledge of that, Senator.

Senator LEVIN. If enacted in its present form, will this bill do the trick? The intent of the bill and the purpose of it are obvious. But, do we also have to change the apportionment law under the Budget Act?

Mr. HOLLOWAY. Senator, I do not know.

Senator LEVIN. We wrote a law back in 1958 which says what I read, to guarantee these bonds even though they are tax exempt. That is what we said back in 1958, and it did not accomplish the goal, obviously, because OMB has decided otherwise. I am just wondering whether there is any doubt in your mind that if the chairman's bill becomes law, that that will accomplish the goal. Do you expect that you might be able to wiggle out of it—not you, but the executive branch—might be able to wiggle out in some way? Can you give us some advance warning?

Mr. HOLLOWAY. Senator, I do not know quite how to answer that except to say that——

Senator LEVIN. I don't know how to ask it. [Laughter.]

Mr. HOLLOWAY [continuing]. If I do not receive an apportionment, we will not be committing funds.

Senator LEVIN. Well, Mr. Chairman, I would just suggest that maybe we take a look, then, at the apportionment provisions in the Budget Act to make sure that your bill will accomplish what you set out to accomplish. I don't want to throw any complications in here but I do think we want to succeed. You have tried to carry the ball here. I would just hate to see OMB come back a year later and say to the SBA, "You can't do it. Here is your apportionment." Mr. Holloway will be here, correctly so, saying, "I am not violating my apportionment."

Therefore, I do think we ought to at least check out that one aspect to make sure that we are really going to accomplish what you set out to accomplish.

Senator D'AMATO. The question is, I understand through counsel, that the only way OMB could do this would be if they were to kill the entire program. Now I don't know, counsel, how would they go about killing the entire program? Is there a manner in which they could do that? Can they refuse to give us funds after we have authorized and appropriated the funds?

Mr. CHVOTKIN. No funds are appropriated. This is a loan guarantee program under the Small Business Act. We appropriate to a reserve account.

Senator D'AMATO. Well, how could we go one step further? I think that would be what Senator Levin was driving at. How could we go one step further to see to it that they couldn't do this?

Senator LEVIN. Let me comment on my own question, because we have had this question come up in another arena. Now the SBA has unilaterally reduced the amount of loan guarantees that we have authorized or appropriated, and I have a bill in which says, "Like hell you can." It is a little more artfully worded than that but it basically would put the loan guarantee program in the same status as our other appropriations and say, "If you want to defer or if you want to rescind, you come in and say, 'Hey, you ignoramuses, you authorized $100 million for a loan guarantee program, and you know the kind of shape this economy is in, and we want you to rescind $50 million of that authority and we will save the $50 million in loan guarantees.' " That is fine, if they want to come in with a rescission or a deferral, but what they are doing with loan guarantees—not just SBA loan guarantees, but VA loan guarantees, all these loan guarantees—they have come in and unilaterally they sent out a notice saying, "Well, we may have worked out this deal with the Congress 8 months ago and the Congress may have passed a certain level of loan guarantees, but the economy is in rotten shape and we are going to cut the $100 million down to $80 million over here, and the $60 million down to $40 million over here."

I have a bill in, and in fact the Senate has already acted on a number of my amendments in this area prohibiting them from doing that. So there is a very basic question here as to the powers of OMB on these programs that I think we should face generically, not just on every bill that comes up. Again, I have done it both on an ad hoc basis with a number of bills but I also have a generic approach to prohibit that kind of unilateral action on the part of

OMB. It is really this issue or close to this issue, and I would hope that this committee maybe would lend some support to that effort. We cannot have a superlegislature over there in the OMB. We just cannot afford it. We have enough of a legislature here.

Senator D'AMATO. Senator Huddleston?

Senator HUDDLESTON. No comments, Mr. Chairman.

Senator D'AMATO. Mr. Holloway, we thank you for coming in. Obviously you know, but I would like to indicate nevertheless, that your own participation I have found to be exemplary. We understand that you have to carry out the law and those charges that you are faced with.

In terms of turnaround time, I have to indicate that our reports come back that you have gotten the word out there, that people in the regional offices indeed are doing an excellent job. I just want to make sure you do not have $150 million left over that should have been utilized, that could have been utilized, to help create jobs, because I don't think the people of this country elect OMB or anybody else to do that. I think if OMB wants to do it, they should go out and run for office. If they want to be the President, they want to be in the Congress, fine, let them do it.

I think that we have the tail wagging the dog. That is what we have here, so I have to lend my strong support for the direction in which Senator Levin is suggesting that we should proceed.

I thank you very much.

Mr. HOLLOWAY. Thank you very much, Mr. Chairman.

Senator D'AMATO. The first panel, Steve Gurian and Scott Berman.

Mr. Gurian, how are you, Steve?

Mr. GURIAN. Senator D'Amato, how are you? I am fine. Thank you for inviting me.

Senator D'AMATO. Would you proceed?

STATEMENT OF STEVEN D. GURIAN, PRESIDENT AND EXECUTIVE DIRECTOR, LONG ISLAND DEVELOPMENT CORP., MINEOLA, N.Y.

Mr. GURIAN. I have a written statement. However, the prior testimony would make my reading redundant at this point other than to qualify myself as a witness. To read into the record from my own statement as to the history of this tax-exempt confrontation with the 503, will add nothing to what had already been said.

Instead, I would like to go on to something which is basic. During the September 1982 hearings, as part of my prior testimony, I responded to the question, Did I or did I not support the parity and superior position? I think I clearly indicated, that while I will support any participation, that without the subordinate position as part of the enactment we really have not done anything.

As in the case that was cited by Mr. Holloway of the four projects in New York State, we are dealing with another Government agency, and when we are dealing with another Government agency whose position really makes no difference. The real question at hand is whether or not the private sector purchaser of an industrial revenue bond will take a subordinate position to the 503. The answer is no.

It is not the Industrial Development Agency enactment of New York State which prohibits buyers to take a subordinate position; it is a matter of banking principle not to take a second position regardless of who the first position is. I thank the SBA and I congratulate them. They did move very promptly with regard to the use of 503 and the tax-exempts on parity. During these past months, there have been much closer and more appropriate relationships between the SBA and the CDC. On their stationery they made it very clear and approved the use of the 503 funds in a pari passu position or a superior position, with the State agencies. It was a meaningful accommodation for the moment to fit into the laws of the State of New York with regard to the Job Development Agency.

However, the real thrust on economic development and job creation comes from the multitudes of dollars and incentives that are made available through the IDA, I will again repeat that those businesses who enjoy the tax exemption of the IDA do not generally need it. It is a true incentive, and it is proper for the businessman make use of it. However, it is the six-figure loan—not the seven-figure loan—that cannot make use of the Industrial Development Agency Act.

The private sector lending institutions will not purchase a six-figure loan in general, by virtue of the size of the borrower, if the bank does purchase, it will not be it at the 90-percent level, but rather at a 50- or perhaps 60-percent level of the hard cost. This forces the small businessman under those conditions, to enjoy that tax exemption of an IDA, to seek secondary financing.

Under our 503 program, the same exact conditions; that is, a six-figure loan, $700,000 for example—we could get a 50-percent bank participation in first place, with the CDC in subordinate position. This gives a blend interest rate that is viable for the small businessman to proceed with expansion plans.

Our performance record shows that the LIDC has been able to do this, we do achieve a very nice blend of commercial first mortgage rates and the 503 rates. These blends have been proven to be very encouraging and indeed and very stimulating, but there is nothing comparing the blend of a tax-exempt 70 percent of prime—which today is in the neighborhood of 8½ percent for the first position mortgage—and today's CDC rate of 10 percent. This blend is a very real inducement and makes the project economically feasible with considerable less risk to the CDC second position. If we are excluded from participation, as we are now, and the commercial banks will not go beyond 60 or 65 percent of the hard cost of a project the medium-size, and small-size company must resort to second-position financing. This is usually at a 20-percent interest rate with short terms. The ability to handle those debt services during the early maturity of any expansion project is very difficult, and is one of the major causes of the failure of these projects soon after they are put on the books.

I also would like to point out that when secondary funds become so onerous, and there is a commitment to proceed, what happens is that the company uses its working assets to make up that shortfall. The working assets are just as much a part of an expansion as the brick and mortar, and the small companies have a difficult time.

The number of bankruptcies that have taken place in the recent past is a pure and simple indication that access working capital funds can be as onerous as access to subordinate position mortgages.

Senator, I will be happy to respond to any questions that you or the committee may have. I thank you again for inviting me, and I certainly commend you and the committee for bringing this matter up. It is an absolute necessity at this time.

Senator D'AMATO. Thank you, Mr. Gurian.

Scott Berman, Scott, it is good to see you again.

STATEMENT OF SCOTT Z. BERMAN, PRESIDENT, LAWRENCE AVENUE DEVELOPMENT CORP., CHICAGO, ILL.

Mr. BERMAN. Good afternoon, Senator. Thank you.

I am here representing the Lawrence Avenue Development Corp., in Chicago, also as the founding president of the Chicago Association of Neighborhood Development Organizations in Chicago, and of course as the vice president for technical issues of NADCO, the National Association of Development Co.

It is in that position I would like first to thank you, Mr. Chairman, and the committee for resolving what was the single most pervasive problem that confronted the Nation's CDC's, that we brought to you on September 28, that of lengthy delays from the submission of a 503 package to authorization or rejection of that package. When we last appeared before you we complained of an average turn-around time of between 6 and 12 weeks, considerably longer than the average time that was indicated by the SBA's response to you of November 17, as printed in the back of their testimony of September 28.

Our experience is completely different, and disputes those figures of the SBA. Since that time however, we have seen a remarkable improvement in 503 turnaround in all parts of the country, and I would commend the committee and also the SBA. Fifteen days is now even a possibility.

I would like to report to you today that all of our problems that we brought to you before were resolved by the SBA as well as was that issue of processing time, but that is not the case. In June of 1982 NADCO, as you know, in its Technical Issues Committee authored a report that detailed specific problems that we were having with the SBA 503 program and which, if implemented, would improve the operating capability of that program and cause us to better market it. That report was submitted to you and the committee.

Administrator Sanders expressed a great willingness to compromise on many of our concerns, and since then and in that spirit we worked with Deputy Associate Administrator Charles Hertzberg to reach agreements on many of those points. In fact, on November 16 we reached agreement on more than half of the points that we had raised. The problem is that we are still waiting for the first SOP or regulation change. We would even welcome an informal memo to the regions or district offices alerting them to anticipated changes, and still nothing has been written, no changes, no memos. We would welcome the continued cooperation of the committee while

we work with Mr. Sanders and Mr. Hertzberg to implement these already agreed-upon changes.

Now to focus on those major concerns of NADCO and the committee, if I can first touch briefly on two, and then speak to the blending of tax-exempts. The SBA has not agreed to change the alter ego rule. That rule prohibits a 503 loan to a business whose ownership is even slightly different than the ownership of the business' depreciable assets, building, and equipment. We continue in our position, and the SBA continues in theirs, and we still have not had any resolution.

Also, the SOP that limits the maximum allowable leasable space in new construction to 15 percent, thus requiring a 503 borrower to have immediate plans to utilize at least 85 percent of total space constructed in new facilities, presents an impractical limitation on potential growth and an uneconomical construction scenario, where a small businessman has to project far in access and build far in access of his immediate needs. This issue also remains unresolved.

The main issue of today's hearing, the pairing of 503 funds with industrial development bonds and other forms of tax-exempt financing, is potentially the most valuable tool that a CDC will have. NADCO enthusiastically endorses and urges passage of your bill, S. 499, which encourages this blend. It would make IDB's available to small businesses which are currently unable to use them, and this use of IDB's with 503 could be the critical interest rate differential, as Steve has said, between a successfully expanding 503 loan recipient and a small business which was unable to apply because the 503 funds alone would not have lowered its debt service sufficiently to permit its expansion.

The SBA argues that both tax-exempt financing and 503 funds can be used in the same transaction if both stand in an equal position as lienholders. NADCO strenuously argues that if this parity of lien position could be arranged, and we think it is very difficult to arrange, it would be totally unacceptable in the marketplace to the private sector banks and insurance companies which we hope to involve. We have confirmed this position with lenders throughout the country.

In Chicago, the Chicago Association of Neighborhood Development Organizations coordinates the Lender Participation Program with the City of Chicago Department of Economic Development. Not one of the 25 lenders who have pledged a total of $70 million in Chicago has said that it would be a part of a tax-exempt/503 parity loan.

Further, it is doubtful, in the opinion of NADCO counsel and of the many participating lenders, that parity of lien position could be adequately and practically drafted and recorded. We checked with all of our title companies in Chicago and with counsel for many of our participating lenders. They all said that even if they were willing to buy into a parity lien program, which they did not think they would be willing to buy into, they did not think that their interest could be adequately protected, anyway.

Finally, the arguments of the Department of Treasury and the SBA of double subsidy are, as Senator Levin said, at best a questionable and overbroad stretching of the word "subsidy."

In summary, NADCO urges the use of tax-exempt financing in a priority position to the subordinate use of 503 funds, and we think that that 503/tax-exempt blend would increase the use of 503 funds by at least one-third in the country. That would make up the deficit for last year of marketing this program. We think there is a tremendous market for this blend, and we are hopeful that it will be realized.

[Material follows:]

STATEMENT OF STEVEN D. GURIAN FOR HEARINGS
HELD FEBRUARY 17, 1983

INTRODUCTION OF STEVEN D. GURIAN

I am the President and Executive Director of Long Island Development Corporation, a Section 503 Certified Development Company for Nassau and Suffolk Counties in New York. I have been involved with SBA programs for over twenty years as President and Executive Director of the Long Island Economic Development Corporation and its affiliates (local development companies under SBA's Section 502 program). I am also President of The Money Store of New York, Inc., a participant in SBA's Certified Lender Program, as well as a consultant with regard to matters concerning industrial development agencies, the New York Job Development Authority and other governmental programs.

Through these and other activities I have been involved in most aspects of government supported economic development assistance funding.

HISTORY OF LONG ISLAND DEVELOPMENT CORPORATION

Long Island Development Corporation was certified by the SBA in October 1980 to make loans under its Section 503 program.

The membership is representative of Nassau and Suffolk County and includes participants from county and local governments, private industry, professional people (lawyers, accountants, contractors, real estate

brokers), bankers, other economic development organizations, etc. Its board of directors is composed of twenty nine persons representative of its diverse membership. This CDC is managed by its board supported by a finance committee, executive committee, banking relations committee and a professional staff. Long Island Development Corporation works closely with both counties and with the Long Island Economic Development Corporation (a Section 502 local development company).

To date, it has closed twelve loans out of twenty two SBA authorizations. The twelve loans closed resulted in the creation of three hundred fifteen new jobs and the retention of four hundred eighteen. Debenture funds in the twelve totalled $3,026,000. Private sector funds totalled $4,095,000. Community injection funds totalled $1,333,200.00. In addition, Long Island Development Corporation has assisted three other small business concerns to obtain direct loans from the SBA under its 7A program. SBA funding therein totalled $306,500. Private sector participation was $478,695. Company participation was $87,200.00. Eighty six jobs were created or retained by these three projects.

Long Island Development has also assisted numerous other small business concerns seeking financing for expansion and consequent job creation by referring them to other applicable programs.

There have been no defaults in our portfolio. One of the twelve loans closed has been paid off thus far.

ECONOMIC CONDITIONS OF AREA SERVED

Long Island Development Corporation operates

in Nassau and Suffolk Counties and their environs.

The counties have a combined unemployment rate of 5.9 %. This low rate may in part be attributed to the availability of numerous financing vehicles (SBA/IDA/JDA) leading to increased job opportunities. Industry is diversified and service oriented.

TAX EXEMPT ISSUE

The Legislature's intent in enacting the 503 statute was clearly stated in the June 12, 1980 Conference Report (accompanying S 2698):

> SBA should not disapprove the guarantee of any debenture or any loan made with the proceeds of a debenture issue, solely because the proceeds would be used in a project whose other sources of financing include or are collateralized by , tax exempt industrial revenue or development bonds.

The original regulations concurred in stating that:

> SBA may participate in projects whose other sources of financing include or are collateralized by tax exempt obligations. Further , loans made with the proceeds of 503 debentures may be subordinated to such obligations. 13 CFR 108.503-4(c) 1980.

SBA policy however prohibited participation if other sources of financing included or were collateralized by tax exempt obligations. SBA Standard Operating Procedure Section 50, #23, Rev. A 2/5/82, p.36.

Pursuant to the September hearings, SBA has revised this policy to the extent of permitting participation with

tax exempt loans as long as SBA is in a shared or superior mortgage position to the tax exempt financing. See attached letter.

We are aware of and endorse the presently pending bill clarifying and reinforcing the intent of the original statute. Ability to use Section 503 funding in combination with tax exempt funding provides another weapon in the arsenal of last resort inducing financing for expansion, retention or creation of small businesses.

Industrial development tax exempt bonds generally cannot be used by small to medium size businesses because the tax exempt financing cannot be sold to the private sector financial institutions at a ninety percent level. Small to medium size business expansion projects average in the six figure range. Commercial banks are not amenable to purchasing industrial bonds of this size. The majority of offers for six figure project financing have been at sixty to sixty-five percent of the hard costs of the project. This requires either (a) second position financing at high rates for short terms (which creates cash flow havoc in the early maturity) or (b) diversion of the small business concern's working assets which contributes to business collapse.

The availability of Section 503 funds to fill in the subordinate position gap would greatly enhance the ability of small businesses to expand.

PROBLEMS RESULTANT FROM INABILITY TO
COMBINE TAX EXEMPT WITH 503

As executive director of Long Island Development Corporation, the undersigned has received numerous inquiries and has had discussions with small buisness owners contemplating capital asset expansion. Many potential quality projects had to be abandoned for reason of unavailability of economically feasible second position funds as a result of the "tax exempt ban". The use of 503, in conjunction with the Non Federal Funds, without restriction by reason of tax exempt will prove to be another powerful tool encouraging economic development by the small business sector.

Steven D. Gurian

U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

JAN 14 1983

Mr. Steven D. Gurian
Long Island Development Corporation
1501 Franklin Avenue
Suite 301 A
Mineola, New York 11501

Dear Steve,

This is in reference to our discussion today concerning participation with tax exempt obligations.

You are hereby authorized to participate with a tax free bond lender such as New York State Job Development Authority, or the New York State Industrial Development Agency on an equally shared mortgage position or with the SBA guaranty debenture being in a senior position.

Wayne S. Foren
Director
Office of Lender Relations
and Certification

cc: New York Regional Office
New York District Office

NADCO

Serving The Nation's Certified Development Companies

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STATEMENT OF

SCOTT Z. BERMAN

President
LAWRENCE AVENUE DEVELOPMENT CORPORATION
Chicago, Illinois

Vice-President
CHICAGO ASSOCIATION OF
NEIGHBORHOOD DEVELOPMENT ORGANIZATIONS

Vice-President
NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES
Washington, D.C.

Committee on Small Business
U. S. Senate
Washington, D.C.

February 17, 1983

1050 - 17th Street, N.W. · Suite 900 · Washington, D.C. 20036 · 202/296-6212

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Good Morning. My name is Scott Berman. I am the President of and Attorney for the Lawrence Avenue Development Corporation (LADCOR) in Chicago, the Founding President of the Chicago Association of Neighborhood Development Organizations (CANDO) and the Vice-President for Technical Issues of the National Association of Development Companies (NADCO). NADCO is the professional trade association of SBA 503 Certified Development Companies (CDC's). NADCO's members include the largest, most active, and most sophisticated CDC's in the nation. CANDO represents most of the neighborhood based economic development and revitalization groups in Chicago.

The Lawrence Avenue Development Corporation is an active CDC which is representative of most of CANDO's and NADCO's membership. LADCOR's purpose is to create and retain jobs and to develop and revitalize the commercial and industrial economy of a nine square mile section of the northwest side of Chicago. LADCOR was begun in the mid-1970's by a consortium of community and business groups under the umbrella of the North River Commission, an organization of local businesses and community groups, banks, savings and loans, churches, synagogues and schools. It was, and is today, funded by those members, loan packaging fees, and a small Community Development Grant from the City of Chicago. I served as LADCOR's first Executive Director. In its early days, prior to the SBA's 503 or predecessor 502 program, LADCOR packaged loans for small businesses and arranged financing through local banks. Then, and now, LADCOR also provided architectural assistance to rehabilitate

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private property, planning expertise for public area improvements, and staff for promotion, marketing, and business development and expansion. In September of 1976, LADCOR was named by then SBA Administrator Mitchell Kobelinsky as one of the first Local Development Companies (LDC's) in the nation, certified to operate under the newly created SBA 502 program. We at last had a long-term, incentive financing program to use as a tool for the economic revitalization of our neighborhood. We worked closely with our local banks and the Chicago office of the SBA to make the program work. LADCOR was trusted and respected by the businesspeople, the residents, the banks, and the SBA and we became a quasi-field service office of the SBA. From 1976 to the present, LADCOR has packaged 3.5 million dollars in conventional loans and in SBA 502, 503, and 7A Direct and Guaranteed Loans, which generated more than 8 million dollars in additional public and private investment, catalyzed major developer investment in excess of 15 million dollars, and retained or created 500 jobs.

First I would like to thank the Chairman and the Committee for resolving what was the single-most pervasive problem that confronted the nation's CDC's -- that of lengthy delays from the submission of a 503 package to authorization or rejection by the SBA. When we last appeared before you in September of 1982, we complained of an average turnaround time for 503 loans of from 6-12 weeks, considerably longer than the average time indicated by the SBA's November 17, 1982 response to the committee and the 15 days required by the SBA's Standard Operating Procedures. Since

our appearance before you last September, we have seen a remarkable improvement in 503 turnaround time by SBA offices in all parts of the country - even 15 days is now a possibility.

I would like to report to you today that all of our problems and concerns have been resolved by the SBA as well as has the issue of processing time. That unfortunately is not the case.

In June of 1982, the Technical Issues Committee of NADCO, on which I serve as chairman, authored a report which detailed 35 specific problems and recommendations for change in the 503 program, which, if implemented, would improve the operating capability and effectiveness of the program, thereby enhancing the program's utility and marketability. That report was submitted to you with our testimony last September, and was answered (mostly in the negative) soon thereafter by the SBA. Administrator Sanders has since expressed a great willingness to compromise on many of our concerns. In that spirit we worked with Deputy Associate Administrator Charles Hertzberg and had reached what we thought were agreements on many issues, including clarification and relaxation of job creation/retention criteria; special purpose building requirements; limitations placed on small business concern expenditures made in anticipation of 503 loan application; composition of CDC boards; CDC packaging fees; and taxable earnings on reserve and escrow accounts. That was on November 16, 1982. We are still awaiting the first SOP or regulation change. We would even welcome an informal memo to the Regional and District Offices alerting them to anticipated changes. Nothing has been written by the SBA:

all of the objectionable rules and policies remain unchanged. Please do what you can, Mr. Chairman and members of the committee, to get the SBA to implement these already agreed upon changes.

Now we come to those major concerns of NADCO and its member CDC's on which agreements could not be reached with the SBA. These include, first: the Alter-Ego rule, which prohibits a 503 loan to a business whose ownership is even slightly different that the ownership of the business' depreciable assets, building and equipment; second: the SOP which limits the maximum allowable leasable space in new construction to 15%, thus requiring 503 borrowers to have immediate plans to utilize at least 85% of the total space to be constructed in new facilities - an impractical limitation on potential growth and an uneconomical construction scenario; and third: the prohibition of the subordinated use of 503 funds to tax exempt financing.

The pairing of 503 funds, Industrial Development Bonds (IDB's) and other forms of tax exempt financing is potentially the most valuable development tool that a CDC will have. It would make IDB's available to small businesses which are currently unable to use them. This use of IDB's with 503 could be the critical interest rate differential between a successfully expanding 503 loan recipient, and a small business which was unable to apply because the 503 funds alone would not have lowered its debt service sufficiently to permit its expansion. The majority of conventional first mortgage financing is at a prime plus rate. If tax exempts are at 70% of prime, the savings to our small

business clients will be 4 to 6 points in lower debt costs. For a good growth small business, this savings can be of critical significance, especially during the first few years after fixed capital expansion. A major argument for promoting the SBA 503 program is the ability of the small business to retain as much available cash as possible to meet working capital needs. The availability of tax exempt financing would further improve the small businesses cash flow. The pairing of tax-exempt financing with 503 funds would also encourage public-private partnership - the involvement of banks with the 503 program - a major goal of the program.

The SBA argues that both tax-exempt financing and 503 funds can be used in the same transaction if both stand in an equal position as lien-holders. NADCO strenuously agrues that if this parity of lien-position could be arranged, it would be totally unacceptable in the marketplace to the private-sector banks and insurance companies, which we hope to involve. We have confirmed this position with lenders throughout the country. In Chicago, the Chicago Association of Neighborhood Development Organizations (CANDO) coordinates the Lender Participation Program with the City of Chicago Department of Economic Development. Not one of the 25 lenders who have pledged a total of 70 million dollars to our program in Chicago has said that it would be a part of a tax-exempt - 503 parity loan.

Further, it is doubtful, in the opinion of NADCO counsel and of the many participating lenders, that parity of lien position could

be adequately and practically drafted and recorded.

Finally, the arguments of the Department of the Treasury and the SBA of "double-subsidy" are, at best, a questionable and overbroad stretching of the word "subsidy."

In summary, NADCO urges the use of tax exempt financing in a priority position to the subordinate use of 503 funds.

Thank you again for giving us this opportunity to present testimony today, and to discuss our recommendations for changes with you. We, of course, appreciate your ongoing support for this important program and your concern for its efficient operation.

Senator D'AMATO. Thank you very much, Scott, for taking of your time in making those cogent observations. As you and Steve have indicated, you have a very real feeling and concern that 503, as it relates to the needs of providing capital at costs that will encourage business success, is something that would really be given a great lift, not only in the numbers of dollars that would be utilized but maybe even in holding the default rate down to even less than the so-called 1 percent that we might have now if IDB's were used, because the costs would be cut appreciably. Is that not correct?

Mr. BERMAN. That is correct.

Mr. GURIAN. Absolutely.

Senator D'AMATO. Now you both testified that in attempts to utilize the so-called compromise, the great compromise that Treasury put forward, the parity, that you have in the field ascertained from the banking community that they would not become involved in assuming a secondary position. Is that a fair statement?

Mr. BERMAN. That is correct.

Mr. GURIAN. A very fair statement.

Senator D'AMATO. Now, Mr. Berman, in your statement you talked of the fact that in Chicago a number of institutions have indicated a willingness to provide up to some $70 million.

Mr. BERMAN. That is right.

Senator D'AMATO. However, none of those moneys would be made available if they were in a secondary position.

Mr. BERMAN. That is correct. They obviously need that primary position, which is why they went into the program in the first place, and that is what they respect the IDB giving them. When asked this question, they said they always thought IDB's were in a priority position and they would not even consider an IDB possibility if it was not. Certainly the pledged moneys without IDB's that we are already enjoying with the lenders' participation program in Chicago are always in priority position over and above the subordinate position of the 503 funds.

Senator D'AMATO. Therefore, consequently what we are really saying is that an offer of the use of IDB's where there is so-called

parity or where there is a primary position, is one in which the banks will not take a secondary position, and consequently it is no offer at all because it won't be undertaken.

Mr. BERMAN. Those were my words exactly: It is no offer at all.

Senator D'AMATO. OK.

Senator Huddleston?

Senator HUDDLESTON. Well, just one question: Would you say that the most significant thing that could be done with the program to make it more useful, more effective, would be the question of the tax-exempt issue?

Mr. BERMAN. Let me say the most significant thing was already done, and that was the expediting of processing time. I think that the slowdown of processing is one of the major things that caused there to be a lack of use of the 503 program last year.

Senator HUDDLESTON. However, that has been fairly well taken care of.

Mr. BERMAN. Yes, that is right, and I want to say that that is wonderful. Now the next largest issue to overcome is this issue of IDB's, and if we could get over this IDB/tax-exempt issue, we could probably use the program to a full one-third or maybe one-half more. Some CDC's have told us around the country that they could double their movement on this program. They have indicated that many large industries are ready and willing to invest using this blend.

Senator HUDDLESTON. There is no way to estimate how much that would result in additional employment, I guess.

Mr. BERMAN. Only that we can double the figures or increase by one-third the figures that we already have.

Senator HUDDLESTON. Thank you, Mr. Chairman.

Senator D'AMATO. Do we have any figures, I am wondering—and Mr. Holloway is back there, if anyone could help us—developed in terms of what have we averaged per $1 million out in loans in terms of jobs produced? Do we have any figures relative to that? We should be able to develop that figure. Yes, sir?

Mr. HOLLOWAY. Senator, if I may, I would be pleased to submit for the record figures along those lines.[1]

Senator D'AMATO. Would you?

Mr. HOLLOWAY. Yes, sir.

Senator D'AMATO. It would be a good idea, so that we can make an estimate as to every $1 million in loans, what does that produce or what have the results been in terms of jobs, the jobs that have been created. I think that would be a good kind of thing for us to have.

The computer over here says 336 jobs per $1 million. Every $1 million in loans, if that yields, I guess that would be just about it, 300 jobs—$100 million would give you 10 times that. Thirty thousand jobs, is that what we are talking about? That is a pretty good way of creating jobs.

Maybe we ought to go back up to Stockman and tell him that here is a way of creating more jobs, and not really costing the Federal Government nearly as much, because you have less than a 1 percent default ratio. If we could even lower the interest cost a

[1] Information not available at time of going to press.

little lower, then the chances of businesses being able to be successful in their endeavor by keeping those interest rates down, which are a very real cost factor, the probability gets even better. Wouldn't that be something? We could get a whole program going there in the private sector. That sounds like any conservative-thinking person would really favor that, doesn't it?

Senator HUDDLESTON. It seems clear to me.

Mr. BERMAN. Senator, we have seen it be a very effective job-producing mechanism in the field, because it puts the jobs not only in the private sector (these are not make-work jobs), but it puts them in businesses that are already ongoing and have good growth rates. These are businesses that are already in the community, that we in our various CDC's around the country are serving.

Senator D'AMATO. Did you ever hear the story about nobody wanting to tell the king that he didn't have any clothes on?

Mr. BERMAN. Yes.

Senator D'AMATO. I think that is the problem. Nobody wants to tell the king that he really don't have clothes and he is going the wrong way. I mean, these poor guys, they don't dare do that. Next thing they know, they will start eliminating positions.

Can he do that under warrant, too, or one of those things, hold up your——

Mr. HOLLOWAY. Apportionment, Senator? I don't know.

Senator D'AMATO. We don't want to test it out, though.

Well, Scott and Steve, I want to thank you both so very much for coming in once again and sharing with us what your experience has been. I think we should point out that the SBA in its administration has made very, very significant strides and improvements in dealing with the 503 problem, in dealing with turn-around, perhaps due to the many who testified here before as to the inordinate delays, and they should be commended for moving in that manner.

Mr. GURIAN. Absolutely.

Mr. BERMAN. We agree, and we do commend them.

Mr. GURIAN. May I take one parting shot? As the Senator from New York, you know the extent of the use of the industrial revenue bonds, particularly in Nassau and Suffolk Counties, as part of the total bag of development tools that we have available. We now enjoy something less than 6 percent unemployment. I think that speaks for itself. If we could just unleash that one other tool additional 503 with tax exempts which is really directed at the smaller to medium-size company, we really would be able to answer Senator Huddleston's question. You must remember that many of these projects are aborted for lack of proper financing. In the abortion you sometimes lose jobs rather than create.

Senator D'AMATO. I wish you had not told the Senator we are down to less than 6 percent because now he is not going to view my request with as much favor as he has done heretofore.

Senator HUDDLESTON. I'm sorry he brought up abortion. I thought that was another committee. [Laughter.]

Mr. Chairman, for the benefit of Scott Berman, Senator Dixon—who, as you know, is very much interested in this program, has worked on it, and favors it—would have been here. He is a little bit indisposed due to a minor operation.

Mr. BERMAN. Thank you, Senator. I received a call from his aide, Charlie Smith, yesterday, who told me the same thing.

Senator HUDDLESTON. Thank you.

Mr. BERMAN. Thank you.

Senator D'AMATO. Thank you, Senator.

Hon. Robert Bowman, commissioner of economic develoment from the great city of Louisville in the great State of Kentucky; and Mr. William Kelley, president of the Hancock Bank & Trust Co., Quincy, Mass. Quincy is doing too well. They are taking all of our jobs from New York up there.

Senator HUDDLESTON. I thought we were getting all of them. [Laughter.]

Senator D'AMATO. Hello, Commissioner. It is good to see you here.

Mr. BOWMAN. Would you like me to go first?

Senator D'AMATO. Let me tell you, that is what this Senator told me.

STATEMENT OF HON. ROBERT Y. BOWMAN, COMMISSIONER, OFFICE OF ECONOMIC DEVELOPMENT, CITY OF LOUISVILLE, KY.

Mr. BOWMAN. First I would like to thank you, Senator D'Amato, and of course our senior Senator Huddleston, for allowing us to appear before the committee. I am here today on behalf of Mayor Sloane, and we would like to go on record in favor or support of S. 499 before this committee.

We feel that our record of production of industrial development bonds in Louisville, and SBA section 503 loan packages, has given us hands-on experience, and it is documented as follows: Let me say that I support—before going into these numbers—exactly what the two gentlemen before me had presented. Because of the time factor, we were not able to contact all bond counsels and all banks, but they did not receive the idea of the secondary position for IDB's with a favorable comment. Let me put it that way.

During the period from January 1979 to December, 1982, the city of Louisville Office of Economic Development produced some 67 IDB packages with a total output amounting to $129,280. An offshoot of this activity was the creation of 2,355 jobs which were added to 7,091 jobs retained for a total of 9,446 jobs or employed persons. The cost per job created and retained was $13,741.

The figures for the SBA section 503 loan program—and keep in mind that Louisville led the Southeast District in SBA 503 loans—for the period running from May 1982 to December 1982, there were seven loan packages completed with a total output of $1,960,000. The employment offshoot of this was the creation of 106 jobs which were added to 282 jobs retained for a total of 388 employed persons. The cost per job created and retained was $5,051.

Because of the figures mentioned previously which you presented, I am not sure that our district figures were quite accurate, so I am going to skip one paragraph of comparisons and get to the point.

If the 503 and the IDB financing can be used together, we can: One, increase job creation; two, minimize tax loss; three, minimize

interest charged to small businesses; and, four, create aggressive methods of financing. We strongly support Senator D'Amato's bill. We believe that this legislation would serve both the administration's goal of improving the economy and the congressional intent of allowing 503 financing in projects that include or are collateralized by tax-exempt industrial revenue bonds.

Our experience in Louisville shows us that as the Federal Government moves to limit the issuance of IDB's, we believe it should make more flexible other programs that could fill the void created by this limitation. The combination of IDB's and the SBA 503 program would allow for a reduction in total dollar amounts of IDB's issued, without reducing the number of businesses being assisted.

The proposed legislation would assist in dealing with two basic financing problems that exist in the city of Lousville: First, our private sector lenders are generally not willing to do small business financing for a term of maturity longer than 10 years. This occurs regardless of the method of financing, whether that be IDB's, the private sector portion of the 503 loan, or conventional loans. The use of the IDB as part of the 503 package would help the borrower by decreasing his interest costs, thus helping to offset the short-term maturity problem. Second, many of our IDB purchasers already have what they consider to be a high proportion of tax-exempt income in their portfolios. This legislation will allow the city to maximize the remaining funds available by utilizing a smaller IDB per borrower, thus reducing the IDB amount in the package but not the number of businesses being assisted.

In closing, I would like to thank my staff for their prompt response, on short notice, to my request for the information and position clarification which I have just presented to you. I am proud of their past and ongoing efforts to utilize whatever resources are available for improving the city of Louisville's local economy, and hence, the quality of life for all Louisvillians.

Mayor Sloane and the city of Louisville are pleased by your aggressive approach to solving these problems. We encourage you to go even further in your examination of alternatives.

Of additional benefit to the city of Louisville would be an expanded 503 program that would increase the current $500,000 SBA ceiling. This could be important in terms of further reducing the IDB funds in a particular loan package. For us, it would mean the ability to further conserve what funds our local lenders have available for IDB purchases.

In these matters the city of Louisville's interests are identical to those of the Federal Government: to cut down on the dollar volume of IDB's while encouraging business expansion by utilizing attractive financing packages. Even further in terms of creativity would be the ability to combine the IDB and the 503 with UDAG. Our responsibility is to decrease our costs—taxes avoided—and increase our income—taxes paid. These scenarios encourage just this kind of maximization of resources in that we are increasing both unearned income taxes and employment taxes, while providing businesses with a mechanism designed to minimize their borrowing costs.

I do not know if you are aware of this, Senator, but Louisville has pretty much led the Nation in a lot of ways in packaging innovative downtown revitalization and historic preservation projects,

as evidenced by the Galleria and the Broadway Corp./Brown Hotel Renovation.

Senator D'AMATO. I will have to come down with Senator Huddleston and check that out, and have a Small Business hearing over there.

Mr. BOWMAN. We would like to thank you, though, Mr. Chairman, for the time and consideration that you have offered us, and we fully support S. 499.

Senator D'AMATO. Thank you very much, Commissioner.

Mr. Kelley?

STATEMENT OF WILLIAM E. KELLEY, PRESIDENT, HANCOCK BANK & TRUST CO., QUINCY, MASS.

Mr. KELLEY. Thank you, Senators.

It is always tough to be the last witness here. I thought I had a couple of fresh paragraphs after Mr. Gurian and Mr. Berman, but the Commissioner just took care of those. I will be brief.

In addition to being president of the Hancock Bank in Quincy, Mass., a commercial bank of about $195 million total assets, I also serve as chairman of the board of the Massachusetts Industrial Finance Agency in Boston, and am the immediate past president and have been long involved with the South Shore Economic Development Corp. in Quincy. I always list the Hancock Bank first because that is the only one of the jobs that pays and puts food on the Kelly table. The others take a fair amount of time.

I welcome this opportunity to discuss with you and to enthusiastically endorse your proposed amendment to the Small Business Investment Company Act, S. 499, to mandate to the SBA the approving of the coupling of 503 debentures with industrial revenue or development bonds.

As indicated by the heading at the top of my statement, I have had a great deal of involvement in all aspects of the subject at hand. During my long and continuing involvement with the South Shore EDC, we have been one of the most active LDC's in the country. This includes much activity under the old 502 program as well as under the present 503 program. We have closed some 62 loans involving in excess of $20 million and created more than 2,750 new jobs.

I did a quick calculation while you were talking with the previous speaker, and that comes out to about 137 jobs per $1 million. I might also mention that most of those jobs are manufacturing jobs, and as you know there is a well-established principle that there is a multiplier effect of two-plus other jobs, primarily in the service industry, to support these manufacturing jobs, so there really is a far-flung effect.

My bank, the Hancock Bank, has been very active in lending to the smaller businesses in our area. In addition to being designated by the SBA as the certified lender for our home county, we have also been involved very heavily in the 502 and 503 programs. We have made 18 loans. We have also been the purchaser of 14 MIFA—that is the Massachusetts Industrial Finance Agency—bonds. It has been gratifying to be of assistance to these growing

businesses with the related benefits to the community, and, I might add, it has resulted in some excellent business for my bank.

My active involvement with MIFA is of quite recent vintage. I was just appointed chairman in December 1982. From my bank's activity in the program and research I have done on the agency, I can inform you that MIFA, under the astute direction of Robert Patterson, our executive director, has been a real force in the development and retainage of jobs in the Commonwealth. I refer you to schedule A, which is attached, for a recitation of the accomplishments of MIFA since it began operations in 1978. Schedule A is an extract from the annual report that will be forthcoming from MIFA very shortly, and indicates that for the period 1978 to 1982, that $1,650,000,000 of projects have been approved and closed, creating 58,000-plus jobs for the Commonwealth. We also enjoy—as do Nassau and Suffolk Counties—we enjoy a pretty favorable unemployment rate at this point.

I have dwelt at some length on my experience with the now-extinct—I was happy to find out it wasn't extinct—502 program. If there is a few million left kicking around, they can send it up to Quincy and we will put it to excellent use. The 503 program, as it is now administered by the SBA, and the use of industrial revenue bonds, I feel that a consideration of the interrelationships between these types of financing leads to a very important point.

First let me compare the 502 and 503 programs. The old 502 program had a considerably lower rate of interest on the SBA's portion of the loan than the debenture rate for the SBA's portion of the 503 loan. I remember well the confusion and disappointment experienced by borrowers in 1980–81 when the 502 program died down and the regulations for the 503 program were being developed by the SBA. There was much disenchantment on the part of these borrowers when they realized that their carrying costs under the 503 program would be considerably in excess of what they had planned on under the 502. My recollection is that three or four projects that we had approved at the EDC were abandoned at that time.

While our EDC has gone forward and used the 503 program quite actively, in relation to some other parts of the country, I know from my experience at the bank that the 503 is looked upon much less favorably than its predecessor.

Concerning the IRB's, it is obvious from the record of MIFA as set forth in schedule A that this vehicle has been well used in Massachusetts, but there are some problems with the IRB's. First there is a lack of any governmental guarantee to assist in making a somewhat riskier loan. This precludes many smaller, and/or newer, thinly capitalized companies from utilizing this financing vehicle.

In addition, the new minimum tax provisions of TEFRA have forced banks, as the purchasers of IRB's, to quote higher rates in order to end up with the same effective return as in the past. In the case of Hancock Bank and its holding company, the Bank of New England Corp., the TEFRA formula dictates a rate higher by seven tenths of 1 percent or 70 basis points, to be equivalent to the return on the IRB's prior to TEFRA. On top of these problems is the prospect of generally lower earnings for banks in the future as

a result of the deregulation taking place in our industry. There just is not going to be present the ability to absorb unlimited tax-free income.

This brings me to the point that I feel that the passage of this legislation would be a very positive step toward solving the problems I have just outlined. The combination of a tax-free industrial revenue bond in a senior position with a Small Business Administration loan in a junior position will provide the lowest overall cost financing package available. As the country begins to emerge from the long recession, I feel that this program will be well utilized. In addition, it will require the banks to tie up smaller amounts of funds in an individual project, thereby enabling the banks to fund more projects with the limited funds available.

I am aware of the position of the SBA, the Treasury, and the OMB concerning this legislation, and I think that SBA's suggestion that the 503-guaranteed portion of the loan package be at parity with an IRB is neither a salable nor a logical concept.

The smaller business needs the underlying guarantee of the SBA for the package to be bankable. The SBA was set up by Congress to support and encourage small business. The least the SBA can do, it seems to me, is to make available for small businesses the same opportunities that large businesses can utilize, such as the UDAG program where the Government actually gives money for projects which also involve the use of industrial revenue bonds. It seems inconsistent to me for them to do that on the one hand for a large business, and to block this program which would assist the smaller businesses.

It is indeed regrettable that the administration cannot raise its sights and view the effect of this legislation on the economy as a whole. If it did, and recognized the positive effects of reduced expenditures for unemployment and welfare payments, increased revenues at all levels of Government from the profits generated by these borrowers, taxes paid by their employees and real estate taxes on the newly constructed plants, I am sure they would reconsider their position.

I think the two examples cited—not in my remarks—the two examples cited by the SBA both employ actual Government funds. I think that puts them in a category entirely different from what we are talking about here and what this legislation is intended to accomplish. I would guess that certainly in the case of the Commonwealth of Massachusetts, they are not looking to sell bonds in any great numbers and I am sure that these funds are very limited. For the program to be successful, there must be the participation of the commercial banks, in my opinion. For the smaller borrowers, the bonds are not terribly marketable. It has to be something that the banks can live with, and this parity situation, going 80, 90 percent, it just is not bankable.

I call attention to Mr. Holloway's statement toward the end that the SBA is promoting the maximum feasible economic development and job creation. That is what they ought to do, and I guess maybe our message, as has been pointed out here, goes to OMB rather than specifically to the SBA.

I thank you for the opportunity to speak on this legislation. I and my associates in Massachusetts are extremely supportive and

would be very happy to do anything that we can to help it become law. Obviously our Senator, Senator Tsongas, is supportive, and we certainly are as well.

I would be happy to try to answer any questions you may have.

[Material follows:]

STATEMENT BY:
Mr. Robert Y. Bowman, Commissioner
Office of Economic Development
City of Louisville
609 West Jefferson Street
Louisville, Kentucky 40202

BEFORE SUBCOMMITTEE ON 503 LEGISLATION
SENATE SMALL BUSINESS COMMITTEE
FEBRUARY 17, 1983

First, I would like to thank Sen. Weicker, Sen. D'Amato, Sen. Huddleston, and the other honorable members of this Committee for the opportunity to testify before this Committee.

I am here today to testify on behalf of Mayor Harvey I. Sloane and the City of Louisville, and would like to go on record in favor of the proposed legislation before this Committee. We feel that our record of production of Industrial Development Bonds (IDB's) and SBA Section 503 Loan Packages has given us "hands on" experience, and is documented as follows:

During the period from January, 1979 to December, 1982 the City of Louisville's Office of Economic Development produced sixty-seven (67) IDB's with total output amounting to one hundred twenty-nine million two hundred eighty thousand dollars ($129,280,000). An offshot of this activity was the creation of two thousand three hundred fifty-five (2,355) jobs which were added to seven thousand ninety-one (7,091) jobs retained for a total of nine thousand four hundred forty-six (9,446) employed persons. The cost per job created and retained was thirteen thousand seven hundred forty-one dollars ($13,741).

The figures for the SBA Section 503 Loan Program are for the period running from May, 1982 to December, 1982. There were seven (7) loan packages completed with a total output of one million nine hundred sixty thousand dollars ($1,960,000), The employment offshot of this was the creation of one hundred six (106) jobs which were added to two hundred eighty-two (282) jobs retained for a total of three hundred eighty-eight (388) employed persons. The cost per job created and retained was five thousand fifty-one dollars ($5,051).

According to the SBA District figures, the national average cost per job produced by SBA financing is fifteen thousand dollars ($15,000) and up. As stated earlier, the Louisville 503 Program job cost can be contrasted with other SBA programs to show a job production rate of three (3) to one (1). Therefore, if the 503 and IDB financing can be used together, we can: (1) increase job creation, (2) minimize tax loss, (3) minimize interest charges to small businesses, and (4) create aggressive methods of financing. We strongly support Sen. D'Amato's bill. We believe that this legislation would serve both the Administration's goal of improving the economy and Congressional intent to allowing 503 financing in projects that include or are collateralized by tax exempt Industrial Development Bonds.

Our experience in Louisville shows us that as the Federal Government moves to limit the issuance of Industrial Development Bonds (IDB's), we believe it should make more flexible other programs that could fill the void created by this limitation. The combination of IDB's and the SBA 503 Program would allow for a reduction in the total dollar amount of IDB's issued without reducing the number of businesses being assisted.

The proposed legislation would assist in dealing with two (2) basic financing problems that exist in the City of Louisville. First, our private sector lenders are generally not willing to do small business financing for a term of maturity longer than ten (10) years. This occurs regardless of the method of financing, whether IDB's, the private sector portion of the 503 Loan, or conventional loans.

The use of IDB's as part of the 503 Package would help the borrower by decreasing his interest costs, thus helping to offset the short-term maturity problem. Second, many of our IDB purchasers already have what they consider to be a high proportion of tax exempt income in their portfolios. This legislation would allow the City to maximize the remaining funds available by utilizing a smaller IDB per borrower, thus reducing the IDB amount, but not the number of businesses being assisted.

Mayor Sloane and the City of Louisville are pleased by your aggressive approach to solving these problems. We encourage you to go even further in your examination of alternatives.

Of additional benefit to the City of Louisville would be an expanded Section 503 Program, a program that would increase the current five hundred thousand dollar ($500,000) SBA ceiling. This could be important in terms of further reducing the IDB funds in a particular

loan package. For us it would mean the ability to further conserve what funds our local lenders have available for IDB purchases. In these matters, the City of Louisville's interests are identical to those of the Federal Government, to "cut down" on the dollar volume of IDB's while encouraging business expansion by utilizing attractive financing packages. Even further, in terms of creativity, would be the ability to combine the IDB's and the 503 with UDAG's. Our responsibility is to decrease our costs (taxes avoided) and increase our income (taxes paid). These scenarios encourage just this kind of maximization of resources in that we are increasing both unearned income taxes and employment taxes, while providing businesses with a mechanism designed to minimize their borrowing costs.

Thank you for your time and consideration.

STATEMENT OF WILLIAM E. KELLEY
PRESIDENT, HANCOCK BANK AND TRUST COMPANY
QUINCY, MASSACHUSETTS
CHAIRMAN OF THE BOARD, MASSACHUSETTS INDUSTRIAL FINANCE AGENCY
BOSTON, MASSACHUSETTS
IMMEDIATE PAST PRESIDENT, SOUTH SHORE ECONOMIC DEVELOPMENT CORPORATION
QUINCY, MASSACHUSETTS

Mr. Chairman and Members of the Committee:

I welcome this opportunity to discuss with you and to enthusiastically endorse your proposed amendment to the Small Business Investment Company Act to mandate to the Small Business Administration to approve the coupling of an SBA 503 debenture with an Industrial Revenue or Development Bond.

As is indicated by the heading at the top of this statement, I have had a great deal of involvement in all aspects of the subject at hand. During my long and continuing involvement with the South Shore Economic Development Corporation, we have been one of the most active LDC's in the entire country. This includes much activity under the old 502 program as well as under the present 503 program. We have closed sixty-two (62) loans involving in excess of $20,000,000 and created more than 2750 new jobs.

My bank, Hancock Bank and Trust Company has been very active in lending to the smaller businesses in our area. In addition to being designated by the Small Business Administration as the Certified Lender for our home county, we have been involved in eighteen (18) 502 and 503 loans. We have also been the purchaser of fourteen (14) MIFA bonds. It has been gratifying to be of assistance to these growing businesses with the related benefits to the community. And, I might

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add, it has resulted in some excellent business for the bank. My active involvement with the Massachusetts Industrial Finance Agency is of recent vintage. I was appointed Chairman of the Board in December 1982. But from my bank's activity in the program and research I have done on the Agency, I can inform you that MIFA, under the astute direction of Robert E. Patterson, Executive Director, has been a real force in the development and retainage of jobs in the Commonwealth of Massachusetts. I refer you to Schedule A which is attached for a recitation of the accomplishments of MIFA since it began operations in 1978.

I have dwelt at some length on my experience with the now extinct SBA 502 program, the 503 program as it is now administered by the Small Business Administration, and the use of Industrial Revenue Bonds because I feel that a consideration of the inter-relationships between these types of financing leads to a very important point.

First, let me compare the 502 and 503 programs. The old 502 program had a considerably lower rate of interest on the SBA's portion of the loan than the debenture rate for the SBA's portion of the 503 loans. I remember well the confusion and disappointment experienced by borrowers in 1980-1981 when the 502 program expired and the regulations for the 503 program were being developed by the SBA. There was much disenchantment on the part of these borrowers when they realized that their carrying costs under the 503 program would be considerably in excess of what they had planned on under the 502 program. My recollection is that three (3) or four (4) projects were abandoned at the time. And while our SSEDC has gone forward and used

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the 503 program very actively in relation to other parts of the country, I know from my experience at the Bank that the 503 program is looked upon much less favorably than its predecessor.

Concerning Industrial Revenue Bonds it is obvious from the record of MIFA as set forth in Schedule A that this vehicle has been well used in Massachusetts. But there are some problems with IRBs. First, there is the lack of any governmental guarantee to assist in making a somewhat riskier loan. This precludes many smaller and/or newer, thinly capitalized companies from utilizing this financing vehicle. In addition, the new minimum tax provisions of TEFRA have forced banks, as the purchasers of IRBs to quote higher rates in order to end up with the same effective return as in the past. In the case of Hancock Bank and its Holding Company, Bank of New England Corporation, the TEFRA formula dictates a rate higher by 7/10ths of 1 percent, (70 basis points) to be equivalent to the return on IRBs prior to TEFRA. On top of these problems is the prospect of generally lower earnings for banks in the future as a result of the Deregulation taking place in our industry. There just is not going to be present the ability to absorb unlimited tax-free income.

Which brings me to the point that I feel that the passage of this legislation would be a very positive step toward solving the problems I have outlined. The combination of a tax-free Industrial Revenue Bond in a senior position with a Small Business Administration 503 loan in a junior position will provide the lowest over-all cost financing package available. As the country begins to emerge from the long recession I feel this program will be well utilized. In

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addition, it will require the banks to tie-up smaller amounts of funds in an individual project, thereby enabling the banks to fund more projects with the limited funds available.

I am aware of the position on the Small Business Administration, the Treasury Department, and the Office of Management and Budget concerning this legislation, and I think that SBA's suggestion that the 503 guaranteed portion of the loan package be at parity with an IRB is not a saleable or a logical concept.

The smaller business needs the underlying guarantee of the SBA for the package to be bankable. The SBA was set up by Congress to support and encourage small business. The least the SBA can do, it seems to me, is to make available to small businesses the same opportunities large businesses can utilize such as UDAGs.

It is indeed regrettable that the Administration cannot raise its sights and view the effect of this legislation on the economy as a whole. If it did, and recognized the positive effect of reduced expenditures for unemployment and welfare payments and increased revenue at all levels of government from the profits generated by these borrowers, taxes paid by their employees, and real estate taxes on the newly constructed plants, I am sure they would reconsider their position.

Thank you for this opportunity to speak on this legislation. I and my associates in Massachusetts are extremely supportive and will do anything you suggest to help it become law. I will be pleased to try and answer any questions the Committee may have.

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ATTACHMENT

SCHEDULE A

EXTRACT FROM MIFA ANNUAL REPORT FOR 1982

HIGHLIGHTS: A successful Massachusetts economy needs expansions by a broad spectrum of enterprises and reinvestment in our historic urban areas. The Massachusetts Industrial Finance Agency was created to promote this growth in a time of high interest rates. Our 1982 annual report highlights the effect that MIFA's incentives have had stimulating new construction, more plant and equipment, revived urban areas and restored older structures throughout the Commonwealth. Over four years MIFA has had a significant impact in several critical areas.

EMPLOYMENT: Companies receiving MIFA financing for plant and equipment expect to create 58,389 new, permanent jobs as a result of their expansions. New construction and rehabilitation will generate 22,000 man-years of construction work.

SMALLER BUSINESSES: In 1982, four of five companies financed by MIFA had sales of less than $20 million, and more than one-half had sales of less than $5 million. Over one-quarter of all assisted firms were founded since 1970, while two out of every three have less than 100 employees in the state.

NEW INDUSTRIAL SPACE: Over 17 million square feet of new industrial space has been constructed in the last four years with MIFA's help.

THE RECORD

Year	Projects	Financings	New Jobs
1982	295	$ 477,615,200	11,331
1978-1982	1,165	1,651,320,000	58,389

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Senator D'AMATO. Thank you very much, Mr. Kelley.

Senator Huddleston?

Senator HUDDLESTON. Well, Mr. Chairman, I have been getting a lot of information that is very similar, and that is that it is a good program that can be made better. I know the job being done by Bob Bowman and Mayor Sloane in Louisville. We have a city that is not blessed, or has not been blessed in recent years, with great economic development on its own. We have had many financial and economic difficulties there in some of our industries. International Harvester was one of our big ones, and General Electric's home appliance center, and we know what has happened to the home-building business. The Ford Motor Co. plant was another that within the general economic trend in the country has impacted on the City of Louisville considerably.

To be able to help take up some of the slack through this kind of activity has been sort of a Godsent. Anything we can do to make it better and improve it certainly would be, it seems to me at this particular time, very advantageous.

Let me ask Bob: Is there any way to say that there is a typical kind of small business or a typical kind of industry that utilizes this kind of financing more than others?

Mr. BOWMAN. I think my colleagues would agree to this, that there is no one deal that is the same.

Senator HUDDLESTON. Everything is different. It covers the whole scope of business activity.

Mr. BOWMAN. I think a lot of this testimony hinges around our ability to respond to that company. We had an example where a company was ready to purchase a company that had gone out of business, but because the combination of the financing packages was not available, we just could not make the deal. We probably could have saved about 20 additional jobs, had we been able to move.

Senator HUDDLESTON. Therefore, flexibility is important.

Mr. BOWMAN. Yes, sir.

Senator HUDDLESTON. It would pay dividends. Thank you.

Senator D'AMATO. I am intrigued, Mr. Kelley, by something that seems so obvious and yet we do not take it up, and that is your statement with respect to what the individual banking institutions will be able to do with a limited amount of capital. I take it from your testimony, that what you are saying is, "Let us utilize as part of the mix that IDB money, and when that is the case, we will be in a position to make more loans down the line to more businesses down the line." Isn't that what you are saying?

Mr. KELLEY. That is correct, Senator. Yes.

Senator D'AMATO. Therefore, we are really going to be able to get a great multiplier effect for each one of the dollars that we actually put out there.

Mr. KELLEY. That is right, and I think that beautiful combination of using less of the bank's money but providing the least costly package for the borrower is just a natural marriage.

Senator D'AMATO. Therefore, when we use less of those moneys, which unfortunately you will probably find become scarcer and scarcer in the chase for capital, it certainly provides you with the

opportunity for more undertakings that otherwise you would be precluded from if you have to take the full bite.

Mr. KELLEY. That is right.

Senator D'AMATO. Not to mention what the cost is with respect to those individual borrowers, and that they may not, in fact, as Commissioner Bowman has indicated, be able as a result of the cost to carry that loan.

Mr. KELLEY. That is correct.

Senator D'AMATO. Therefore, it seems from everything that we hear from the bankers, from the CDC people themselves, and I think from the observations of my colleagues here, that there is a very strong sense and a very strong feeling that indeed a meaningful jobs program can be developed right here utilizing this program.

Mr. KELLEY. There is no question about it in my mind.

Senator D'AMATO. This will help stimulate the private sector, but not with "make work" jobs. We don't want to put someone at the end of a broom when our industrial base is disappearing. Are we going to be service oriented? You pointed out, and I think maybe you should touch—just for the record— for a moment on the creation of industrial jobs. You talked about manufacturing jobs. You created quite a number by the use of industrial revenue bonds up there, didn't you?

Mr. KELLEY. Yes. That number, the 2,750, was the number of jobs created by our economic development corporation, most of which are manufacturing jobs. Now in the MIFA loans, I have forgotten the exact number—I have heard it—a good number of those are not necessarily, and in most cases are not manufacturing jobs. However, to the extent that you are creating manufacturing jobs we feel that there is this multiplier effect. These people, the ones who become employed, they have the money to spend so that the service industries that are servicing them—there is transportation involved, getting material to and from—that is where this multiplier effect comes in as opposed to we service workers who do not really create wealth.

Senator D'AMATO. I would hope that we would be able to go to a markup as soon as possible and that this might be part of the jobs program. I don't think that we can take care of every program the administration or the OMB people may seek to revoke, but I think that then at least that will be their responsibility and very clearly they would be saying to the American people and to the Congress that they have revoked this loan authority. I do not think that we should be afraid to go forward with the responsibility that lies within our domain because this program makes sense. The combination of IDB's with 503 will make it a better program, a less costly program both to the borrower and, I believe, ultimately to the Government itself. It will bring about better productivity. It is a jobs program that makes sense.

Therefore, I for one am certainly going to push ahead. I would like to thank Senator Huddleston and my other colleagues for being here and for lending their great support to this necessary program. I certainly thank you for your participation and your being here.

Senator Huddleston, do you have any comments?

Senator HUDDLESTON. Nothing more, Mr. Chairman.

Senator D'AMATO. This hearing stands adjourned, and I thank all of those who have participated.

[Whereupon, at 3:53 p.m., the committee recessed, to reconvene at the call of the Chair.]

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